S. HRG. 102-54

HEARING ON THE SEMIANNUAL REPORT OF THE RESOLUTION TRUST CORPORATION—1991

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

ON

THE FINANCIAL INSTITUTIONS REFORM, RECOVERY, AND ENFORCEMENT ACT OF 1989 [FIRREA] REQUIRES THAT THE OVERSIGHT BOARD TESTIFY TWICE A YEAR ON THE FOLLOWING SEVEN ISSUES: NO. 1, PROGRESS MADE IN RESOLVING FAILED THRIFTS. NO. 2, THE ESTIMATED COST TO THE U.S. GOVERNMENT OF OBLIGATIONS ISSUED OR INCURRED BY THE RTC. NO. 3, PROGRESS IN SELLING ASSETS OF FAILED THRIFTS UNDER RTC CONTROL. NO. 4, THE ADMINISTRATIVE COSTS INCURRED BY THE RTC. NO. 5, THE RTC'S ESTIMATED INCOME FROM ASSET SALES. NO. 6, POTENTIAL SOURCES OF ADDITIONAL FUNDS FOR THE RTC. AND NO. 7, THE ESTIMATED REMAINING EXPOSURE OF THE U.S. GOVERNMENT IN CONNECTION WITH FAILED THRIFTS WHICH THE OVERSIGHT BOARD BELIEVES WILL REQUIRE ASSISTANCE OR LIQUIDATION IN THE FUTURE.

JANUARY 23, 1991

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THE SEMIANNUAL REPORT OF THE RESOLUTION TRUST CORPORATION—1991

WEDNESDAY, JANUARY 23, 1991

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS,
Washington, DC.

The committee met, pursuant to notice, at 10:00 a.m., in room SD-538 of the Senate Dirksen Office Building, Senator Donald W. Riegle, Jr. (Chairman of the committee, presiding).

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order.

Let me welcome all of those in attendance this morning. We are hearing today from the Treasury Secretary, Nicholas Brady, and the Oversight Board about the funding needs of the Resolution Trust Corporation.

Last November, just before the 101st Congress adjourned, the Senate passed an additional $10 billion in funding for the RTC. Unfortunately, as we know, that legislation did not become law.

Ensuring that the RTC does not run out of money will be the committee's first priority of the 102nd Congress. So this morning, the committee will learn exactly why the RTC needs more money, how much it feels it needs, how it plans to spend that money, and what other costs might be involved if there were further delay in providing money to the RTC.

We also want to know what the RTC has done with the approximately $100 billion it has spent since its inception.

It is my intention to move very quickly on an interim funding package for the RTC.

Now, I think it's well known that many Members have serious doubts about the RTC's current structure and operations. I think it would be inappropriate for this committee to provide long-term funding for the RTC until it has examined those issues in some depth.

Once we have made that examination, which we will do, and reach some conclusion as to what reforms, if any, should be made, then I think we can consider a longer term funding package.

In the meantime, the committee will take up the deposit insurance reform issue, along with the recapitalization of the Bank Insurance Fund and regulatory reform.

On this issue, too, Secretary Brady and his people have been hard at work on that. We've had some conversations on it and we look forward to hearing from him very soon on that issue.

Several Members of the committee have already introduced significant proposals on these subjects. I've introduced a deposit insurance reform proposal. Senator Dixon has presented one on risk-based premiums. Senator Dodd on interstate banking. Senator Wirth on streamlining the RTC and thrift regulation. There are other bills and there may be other Members on both sides of the aisle on and off the committee that will also be putting proposals forward.

So I welcome the chance that we have today to review the savings and loan situation before the administration releases its deposit insurance study.

On the surface at least, there are many parallels between the current banking problem and the savings and loan situation about 6 years ago. Not precisely the same, but some important parallels.

We see a regional economic downturn. We see heavy commercial real estate losses. We see widespread claims that a little forebearance pending a turn-around in the market could solve the problem. And an insurance fund deteriorating much faster than official projections, and these are just some of the common elements.

The two situations may or may not be fundamentally the same, but these parallels are sobering, in any event. I think we have to be aware of them as we take up our legislative agenda for the 102nd Congress.

Now next Tuesday, the Congressional Budget Office will give this committee an update on the condition of the Bank Insurance Fund and clearly, that Fund warrants close examination, and the committee will give it the kind of intense attention that it deserves.

I want to welcome first all the Members of the committee that are here today and our distinguished panel of witnesses that are from the Oversight Board who are also with us.

With that, let me yield to Senator Garn.

OPENING STATEMENT OF SENATOR GARN

Senator GARN. Thank you, Mr. Chairman.

Today, the Senate Banking Committee is continuing with its responsibility for oversight of the resolution of the savings and loan crisis.

Congress cannot escape its share of the responsibility for this process. Congress is provided the authority. Congress must provide the necessary funds.

I find myself, Mr. Chairman, in sort of a déjà vu situation. I don't know how many times we're going to hold this type of hearing and ask the same questions when the answers, at least to this Senator, seem obvious.

You mentioned that in October, we passed $10 billion, which was considered only the minimum amount necessary to carry the RTC to closure while we were out of session.

The Senate Banking Committee did more than that. We provided more than $50 billion to operate for an entire year, which is the normal process for any governmental agency. That's why we have an authorization and appropriations process and say we will fund various governmental agencies for the fiscal year.

And obviously, oversight of those agencies, whatever they are, are appropriate.

We always continue to have hearings. We continue to see how that money is spent year in and year out, as we should.

But here, with an incredible crisis going on, we not only didn't approve a full year's budget; we didn't even give them the money to operate for 3 months while we were gone.

The Senate did; the House of Representatives once again failed their responsibility. And that brings back the déjà vu memories that you well remember in October of 1986, when exactly the same thing happened, when the Senate passed $15 billion of FSLIC recapitalization and the House killed it.

We simply didn't provide the money and so the problem grew absolutely dramatically—$15 billion would not have solved the problem at that time, but it certainly would have minimized it.

I remember one of these fly-by-night operations in California, working out of a glass and steel office building, using brokered deposits, with no retail office whatsoever, advertising country-wide.

It could have been closed in the fall of 1986 for $83 million. But FSLIC didn't have the money because we didn't give it to them. So it was closed in the spring of 1989 for over $800 million, the same institution.

So we allow the brain-dead to continue. We didn't give the regulators the money to close them down and then we second-guess and say, why didn't you do this and why didn't you do that and why did the problem grow so dramatically?

Now I sat in utter disbelief in that late night session last October where once again, we were doing exactly the same thing. All the questions are valid. Is the RTC doing their job? Are they doing it rapidly enough? Are they doing it properly?

All of those questions are proper.

So I don't want to be misunderstood at all by whatever questions the House or Senate wants to ask about the performance. But you can't deny them the money and force them to keep these institutions open. That has been the heart of the problem for several years.

And so we get on this short-leash theory.

Well, I think my record at 16 years in the Senate would indicate that I have a fiscally conservative voting record, along with three or four of the most conservative Senators in the whole United States Senate. So I believe in short leashes.

But I don't believe in choking the animal to death. And that's exactly what we've been doing year after year. Now, it's one thing to make initial mistakes; it is something else to do it over and over and over again, year after year after year, and continue to hold the hearings about how much money we're going to give.

There's a problem out there, an incredibly difficult and serious problem, and all we do is add to it. And we let it grow because we will not give the resources necessary to handle it.

Well, questioning these gentlemen on how they're spending it, that's proper. But not to give them enough money to do the job is just incomprehensible to me. Let's give them the amount of money and if they don't do it right, we can haul them back here and squeeze them and twist them and ask all the questions we want.

But you can't dry it up and choke them to death, and that's what we've been doing for 6 years.

I think it's time the press started to write the story about that, of the failures of the Congress of the United States. It's much more fun to attack the regulators and the administration, whether it's this one or some other, than it is to look at this amorphous body of 535 people, all with their own plan of how to do it.

But collectively, the Congress of the United States has failed, over and over and over again.

Mr. Chairman, I'll put the rest of my statement in the record and save the time.

The CHAIRMAN. You mean there's more? [Laughter.]

Senator GARN. I frankly haven't even started on my written statement. [Laughter.]

[The complete prepared statement of Senator Garn follows:]

COMPLETE PREPARED STATEMENT OF SENATOR JAKE GARN

The Senate Banking Committee is continuing today with its responsibility for oversight of the resolution of the savings and loan crisis. Congress cannot escape its share of responsibility for this process. Congress has provided the authority, and it is the Congress that must provide the necessary funds.

In this regard, I would like to comment on a view that has some following in the Congress, the view that we should keep the RTC on a tight leash. I am not sure where this view came from, but I had thought that the short leash approach to dealing with the Regulators had been thoroughly discredited by now. Congress kept FSLIC on a short leash, a very short leash, so short that we had FSLIC by the throat. Even at the late date of March 1987, when this committee was marking-up the FSLIC recapitalization bill, for the third or fourth time, there were those claiming that we should keep FSLIC on a short leash, that we shouldn't give them too much money. The committee by and large followed that approach, giving FSLIC only half of what was requested. That short leash strategy has been an absolute disaster.

Congress has many strengths, but one of those strengths is not the day-to-day or even the quarter-to-quarter management of programs.

Over the last few days the world has been astounded by the capabilities and achievements of our military forces in the Persian Gulf. Time after time, briefing after briefing, the commanders in the field have attributed much of their success to the freedom of action provided to them. I shudder to think of what the situation in the Gulf would be today if Congress were second-guessing every step made there by our forces in the field. A short leash strategy there would be measured in casualty figures rather than financial estimates.

As we proceed today and in the next few weeks, I hope that we will reject the idea of putting the RTC on a short leash. The RTC has a job to do. Everyone knows what it is. When it is over, they will fold up the tent. I hope that we will give them the resources they need to get the job done at the lowest possible cost. Already we have reports of thrift resolutions postponed because of limited RTC resources. Postponement has its costs, and in the case of insolvent financial institutions, the costs are enormous.

We did not get the thrift crisis because FSLIC had too much money. We got to this $100 billion catastrophe because FSLIC was not provided the resources needed soon enough to deal with the problem institutions before the crisis developed. The bad apples were left in the basket ruining the good ones while we argued over how much to pay to take them out.

I hope that we have learned our lesson and not repeat the same mistake with funding the RTC today.

The CHAIRMAN. Senator Wirth.

OPENING STATEMENT OF SENATOR WIRTH

Senator WIRTH. Thank you very much, Mr. Chairman, and gentlemen, thank you for being here.

Mr. Chairman, it's imperative that we pass the funding bill right away. Last summer, you'll remember, we asked Secretary Brady and the administration to please present us with what budget they wanted for the RTC, and that was not forthcoming, and not forthcoming, and not forthcoming.

We finally heard, I think in the middle of October, what it was that the RTC wanted. The Senate operated quickly, and as Senator Garn has pointed out, it died in the House. But we did not have a request from the administration until very late last year, despite repeated requests from the Chairman of this committee and many of us.

I hope that now we can go ahead and get the funding necessary so that the RTC can do the job.

I hope also, Mr. Chairman, that we have an opportunity very quickly to look at issues of restructuring what appears to me to be an extremely awkward administrative situation.

I'll be reintroducing legislation this year that I introduced last year to abolish the RTC Oversight Board, abolish the Federal Housing Finance Board, abolish the Office of Thrift Supervision, restructure the board of directors of the FDIC and really generally streamline this unbelievably awkward process.

I hear from my constituents on a steady basis that it's very difficult to get anything done out of the RTC. I understand the caution there. But at least I think what we can do is to eliminate a lot of the underbrush in this and get to the point of caution and accountability.

I think many of us are frustrated with the structure and let's see if we can sort that out.

In any case, I'm pleased to have you all here today. Thank you for coming.

Mr. Chairman, thank you for the rapid calling of this hearing. I hope we pass this legislation right away.

The CHAIRMAN. Thank you. Senator D'Amato.

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Mr. Chairman, I think Senator Garn is absolutely correct as it relates to our lack of action going back before the RTC came into being.

The fact that we pussy-footed around without allocating sufficient resources so that we could have minimized losses, and they're still going to be substantial.

I think that the purpose for the hearing today is important to attempt to understand how much money is necessary.

But you know, Mr. Chairman, this problem isn't going to be solved simply by giving them more money. I'm not suggesting that they don't need more, and I think we should.

But if the management continues to pile up more and more assets and the assets continue to go down as they are, and I'm talking about the real estate—they just got another, I don't know how many billions of dollars turned over to them and they tell me as of December 7, the RTC had $19.4 billion of real estate assets. Its inventory is growing. And the value is declining.

Now why?

What I'm going to say maybe is not polite. If you keep the interest rates, Mr. Chairman, and I'm now talking about our Federal Reserve Chairman, at the point that they are, if you discourage institutions from making money, if you're still so worried about inflation that you're a year late as it relates to the recession, and blaming it simply on the Mideast problems is an oversimplification.

And maybe I'm oversimplifying, but I'm sick and tired of hearing that nonsense.

We've got a real recession. And you're cutting the discount rate for the first time by a half-point and then bemoaning the fact that the banks were attempting to keep a little leverage there while they're getting bombed, on the other hand, the right to market, to write down their assets, is incredible. Total lack of sensitivity.

Now I'll tell you, we could give them $80 billion, and we'll have to give them more. There is no liquidity out there.

And if you look historically at the interest rates and the discount rates, you have to go back to 1987 and 1988, and you find that when you cut the discount rate and bring it down, instead of 6.5 percent, to what you had at that point in time. And when you had it at 5.5 percent, at that point in time, it dramatically reduced the prime interest rate.

What's wrong with getting the prime down and helping to stimulate?

You gave a ½ percent cut and we heralded it to the world. Oh, what a wonderful thing.

Too little, too late, Alan, and no one wants to tell you. You're the big guru. We all sit here. And then you say, oh, I see some light. Oh, things may be getting better.

Well, I'd like to know where they are.

Now, this is a sense of frustration that I want to tell you that I share on behalf of my constituents. And I don't know what my friends and colleagues over here think, but if they think that we're going to cure the economy by worrying about inflation, what inflation are you worried about?

You saw inflation going up because the energy prices were going up. If you discounted that, there was almost no movement.

What do you need for people to tell you that the real estate market isn't going to come back and it needs a jump start? And if you don't cut that discount rate, we're going to be back here and those prices and that inventory is going to continue to increase, and the value to decrease.

Mr. Chairman, I had this all in very nice words that my staff had prepared for me. [Laughter.]

All right? They talk about the credit crunch. The credit crunch? We're in the real world. You eat at a different table than most Americans. You take home a different paycheck. Maybe you don't need it, and you're fortunate. But there is a real credit crunch. And we need decisive steps now towards easing that credit crunch.

And it's not just a crunch because as the Ranking Member, Senator Garn, said, we've choked them. We're killing them. And then what you say to the banks, oh, you should pass it on. You shouldn't be looking——

Let me tell you something. Their capital is precariously low.

Now, you want to drive them out of business? We can do it. We'll just pick up a bigger tab for the taxpayer. That's all we're doing. Drive the value of real property down? We'll just make a bigger tab for the taxpayer. And that's what's happening.

Now I've heard you put it in nice ways that you see, what? Oil prices finally came down a little bit. Is that going to be the great thing that you see as the market turning around?

I don't see it turning around. I don't see the economy improving. I think it can. But I'll tell you this. It needs more than a half a percent discount.

Get that discount rate down to 5½ percent. Let's see the banks then lower the interest rates.

And I have to tell you something. You're so worried about inflation. People are going to starve out there and you're going to be worried about inflation and say, guess what? We've eliminated inflation.

I have to tell you you're way behind the curve.

The CHAIRMAN. I'd just make the comment that after hearing Senator Garn and Senator D'Amato, I just can't wait for Senator Gramm. [Laughter.]

But we'll have to wait just a little bit.

Senator Kerry.

OPENING STATEMENT OF SENATOR KERRY

Senator KERRY. You guys must be really thrilled to be here today. [Laughter.]

I do not want to begin this process—we're here to listen to you. But we don't often get an opportunity, obviously, to share that many thoughts with you.

I just want to say that, partly in answer to Senator Garn, I think I was the one Member of this committee who voted against the funding last year. And frankly, the reason was that I think a lot of us are expressing the sensitivity that our constituencies are expressing to us about the fear of the future and about the seemingly endless increase in the numbers and the amounts that are being called on.

And I think last year, when we received a letter requesting additional money, there were many of us who felt that our responsibility demanded that we somehow have a better sense of where that was going, and that we be able to explain to people, as we ought to be able to, how it's being spent.

And I think many of us legitimately felt we couldn't do that. And that's why I think this hearing is so important today.

Mr. Secretary Brady, I would like to just take the opportunity, if I can, and I say this as gently and as nicely as possible because I think we need to have a real dialogue about it and not a shouting match.

But I came just now from a meeting of the New England caucus with bipartisan representation. We met together with businesses and banks—but businesses, most importantly, I think.

There really is a sense of just freefall, meltdown. I want to share that with you because I think, frankly, Senator D'Amato's notion

that you can just lower the interest rates and deal with this now is not totally realistic.

I think there was a hearing in the Banking Committee on the House side the other day with Alan Greenspan, where it's evident that because of the lack of capital, the lack of credit, that even if you lower the rates because of the problems now in terms of the capital requirements and the process of Mr. Clark's approach, that there wouldn't be money available anyway.

And that's the problem. And I think you've really got to step back and look at the question of how you can take loans that would be working at the 80 percent level, but won't work at their full required capital level. And so you write them down to zero instead of the 80 percent and you're making banks insolvent. You're creating, I think, a process that is just becoming a downward cycle, so that no one can open the books on a legitimate deal.

Good deals are not even being banked right now because they can't lend, because they are so caught up in meeting these strict requirements.

And my plea to you is—and you know we're all caught up in sensitivities of the ethics investigation and of regulators and people don't want to get involved, obviously, in some of these meetings. And the result is, candidly, I don't think we're able to represent as well as we ought to be some of the people who need representation.

And so, frankly, I'm going to step out on that. I think we have to. I think we've got an obligation to.

And my plea to you is to take a hard look at this. It is not partisan. It is just a question of good business common sense. We have shown more forebearance and sensitivity to the loans of less developed countries than we have to some very legitimate businesses that have been credit-worthy for years.

And we're going to pay an extraordinary price for it at the back end of this if we don't do that.

The CHAIRMAN. Thank you, Senator Kerry.

Senator Mack.

OPENING STATEMENT OF SENATOR MACK

Senator MACK. Thank you, Mr. Chairman.

There are three questions I guess that come to my mind that really focus this issue. The first one is it seems like we're paying so much attention to how much does the RTC need and how can they be more effective and more efficient in what they're doing, and really have failed to focus on what is the most significant question that will reduce the ultimate cost to the taxpayer.

And that is, what do we need to do in order to get the economy moving again? A growing economy with the right kinds of policies will increase the value of the assets that everyone's concerned about. And we ought to be asking ourselves what are those policies that we need to adjust, that we need to change, that we need to institute to get the economy moving again.

And when it comes time for my opportunity to raise questions, I want to pursue that issue with respect to what do we have to do to get the economy moving again.

But the other two questions I already kind of alluded to in my previous comments, and that is, I think we need to separate the issue, though, when it comes directly to the RTC.

The first question is how much money is necessary for them to carry out the job that this committee and this Congress gave them to do? And then the second question is what has to be done to make you more effective in selling those assets?

And I, like I'm sure all my colleagues on this committee, have been hearing from our constituencies throughout our States that every time that they deal with the RTC, they can't get an answer, that there's a problem with the procedures, that just as they get close to making a deal, a new officer is assigned and they have to start all over again. And eventually, they give up. And what eventually happens is that somebody buys that asset at half the price that the original purchaser was agreeing to pay.

So, again, I think one of the focuses that we should take in the discussion is what do we need to do to get the economy moving again? What needs to be done to increase the value of assets?

And I hope that we'll have an opportunity to pursue that in our discussions.

Thank you, Mr. Chairman.

The CHAIRMAN. Very good.

Senator Bryan.

OPENING STATEMENT OF SENATOR BRYAN

Senator BRYAN. Thank you very much, Mr. Chairman.

There's been a good bit of colloquy this morning about the responsibility of the Congress and the responsibility of this committee.

I'd have to say that since I became a Member of this committee in January 1989, I think the record will reflect that we have responsibly, as a committee with bipartisan support, responded to the original FIRREA. Requested legislation was drafted in the very early part of this administration's term. And in October, when the request came for additional funding, as has been pointed out by several of my colleagues, we've been forthcoming and I think highly responsible in addressing what the needs are.

From my perspective, I think we have a right to expect from you as Members of the Oversight Board to be equally candid and forthcoming with us in terms of, number one, what are your financial requirements? What are you going to ask for? What do you feel that you need? And to give us your best assessment as to what those needs are so that we can hear that up front and early on.

I'd also be most interested in hearing what your thoughts are in terms of restructuring so that this can be made more effective and more responsive.

The comment of Senator Mack and others, I would endorse. There's not one of us who did not hear an ongoing stream of complaints that strike us, at least in the context in which I've heard them, as being highly reasonable, that you can't get an answer. Legitimate business people with legitimate proposals trying to work out some kind of a deal.

You just simply can't get that off.

So, clearly, I think there are major problems in terms of restructuring because it's too ponderous the way it is. I'd be interested in the update in the categories—one, two, three, four. Where are we now? Where do you see us in 6 months? Where do you hope to be a year from now? And finally, one of the festering sores to my own perspective is the 1988 deals and the distaste that many of us feel about the way those were conducted and what is your assessment and what is going to be done with some of those?

And I would think that a full disclosure as to those circumstances ought to be made to this committee, to the Congress, and to the American public.

And I thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Bryan.

Senator Gramm.

OPENING STATEMENT OF SENATOR GRAMM

Senator GRAMM. I'm glad that you on the panel don't get to ask us questions. I'm also glad that nobody expects Congress to have the answers.

But there are several things that I'm sort of struck by so let me work down my list and be brief about it.

First of all, I'm struck by the conflicting message that you're receiving. The message on one hand is, "We've taken a bloodbath within the savings and loans; don't let it happen in other institutions. And oh, by the way, ease up. Forbearance. Eighty percent performance loans."

I think the sad reality is that, whether we like it or not, and I don't like it, there is an inherent conflict in what Congress is asking of you.

If our objective is to prevent another S&L problem in the banking industry, part of what you do to achieve that goal does not help promote the short-term solution we seek to the recession. I'm glad you all are making those decisions and not me.

I'd like to say that I couldn't disagree more with our dear colleague from Colorado. I don't know whether the structure we have now is a good structure or bad structure. But I feel that this is the army we've got to fight the war with and that we need to get on with it. The last thing on earth that we need to do is to be rearranging a system that largely has yet to be put into place.

I keep getting letters saying, don't give the RTC any more money, as if people don't understand that we've already taken responsibility for the problem. The taxpayer has been committed. We've got to spend the money or renege on our commitment to the depositors.

My view is that we ought to provide the money that is necessary to do the job. Of all constraints that you ought not to have, chief among them is that you ought not to be given a cash-flow problem, since we know that the loss is already out there.

I feel very strongly that this is a long-term problem and that we need to provide the resources to get the job done.

I continue to be very frustrated that we are not moving assets. I think you all need to get a good realtor.

When we wrote this law, I spent hours worried about asset dumping, about the collapse of real estate values. And I forgot that we were dealing with Government. [Laughter.]

Now I see all this fancy letterhead that's been printed up by the RTC. I see your employees beginning to qualify for Federal retirement. And I see you becoming the largest property-manager other than the Soviet Union and the governments of eastern Europe, and I see results that are not dissimilar to their experience.

So my own view is that we need to get on with the job of hiring a good realtor, take our losses and sell this real estate, and get out of the real estate business. My own humble opinion is that, in the long run, we will be better off doing so. It will be cheaper for the taxpayer than having the Government enter into this long-term process of managing properties.

Finally, I'm not going to scream and holler about the interest rates, being the voice of reason on this committee. But I would say that I hear people talk about this being a short recession, and I am hopeful for many reasons that this will be the case.

This is not a standard inventory cycle, however. One of the things that worries me is that, in my adult lifespan, this is really the first credit-induced recession that we have had.

Now, obviously, that was a major factor, and I'm in no way comparing this to the Great Depression. But the only experience I have in looking at it is the panic of 1907 and the Great Depression.

Now I don't think anything here is comparable in magnitude, but I think the current experience it is fundamentally different from the inventory cycle recessions we've had. I know we have problems in that we're an international currency. We really don't set our interest rate as we once might have in the short run with monetary policy.

In setting our policy to deal with this recession, we need to realize that, at least as the evidence suggests to me, this is not an inventory cycle. It is a credit-induced recession, and dealing with it is a problem that at some point has got to be done within the constraints of the dollar serving as an international currency.

The CHAIRMAN. Thank you.

Senator Sanford.

OPENING STATEMENT OF SENATOR SANFORD

Senator SANFORD. Thank you very much. Let me make a couple of points and then I look forward to moving as quickly as possible to the witnesses.

In the first place, I generally, as Phil Gramm knows, agree with him on most everything. But I believe that Abraham Lincoln got rid of McClellan. I wouldn't suggest for a minute that we shouldn't at least consider some restructuring.

And I believe that there is no better place for suggestions on restructuring to come from than from you people who are watching the Resolution Trust Corporation. It may very well be that it's too cumbersome involves too much overlapping, and is creating too many bureaucratic problems. And I hope that you will think about it.

It would be a great honor and you'd get great credit back home if you were the only Government officials to abolish your jobs.

You know more on this issue than almost anyone, and I hope that you will turn your creative thinking to how we can make the RTC more efficient than it's been. And I think everybody has to admit that the process is too cumbersome.

I'd like to make one more point simply because you're here and it's relevant and not the subject of the Chairman's call.

I regret very much that Congress and others didn't take proper action in time to avert the S&L crisis. I remember thinking a good while before I became a Member of this body that things were going on in that industry that were very, very dangerous and that the Government didn't seem to be taking it very seriously.

But now we're looking at a banking situation that I think could bring this country to its knees if we don't anticipate it and do something about it.

We've talked about the availability of capital and we know very well that the availability is constrained, and properly so, perhaps, from the point of view of safety.

We see now, three or four plans for increasing the capitalization of banks, and that would do several things. One, it would increase the safety of the bank and consequently, lower the risk of our insurance funds. It would beyond that make credit available without interfering too much with the efforts to keep interest rates reasonable and would keep inflation down if more capital were available.

But the banks can't get more capital simply because no one wants to invest in a bank right now. The death spiral is out there gathering steam and people can see that.

The Association of Bank Holding Companies has a plan that would require banks to bring money together by additional contributions. That's not really bringing in new capital. That's spreading out capital. That's not strengthening banks as much as it is tending to weaken them all, lowering the water level, so to speak.

There have been suggestions that the Federal Reserve has enough money to take charge of the recapitalization. I saw one suggestion that you've got $35 billion in capital which I think is an exaggeration, and that you should give back $20 billion a year to the Government.

Why not put that into the banking system?

Of course, that's money that goes to the Treasury. That would be a direct drain on Government resources. I've suggested to the Secretary and to others that maybe we can devise a way that doesn't cost the taxpayers any money to put in new capital. And I hope that we'll start thinking about this issue now, not after we have to look at it on an emergency basis as we've been forced to do in the S&L business.

I hope that we can start thinking about ways to increase bank capital now. One concept is an emergency bank investment corporation that I think we can find a way to fund without costing the taxpayers any money. We would operate it pretty much the way the Reconstruction Finance Corporation did. However, in this case, instead of making loans to banks, we would literally buy stock in banks.

I think in the long run, it would not only be a saving of interest, but also a saving of the system, a saving of the insurance funds, and a boost to the economy. As a side effect, the investment corporation would probably make more money for the Government per dollar than we did in the Chrysler bail-out.

So I think we can do some creative thinking in how to save banks now by increasing their capital. It's probably not the right place to mention it, Mr. Chairman, but it seems so relevant to me.

Thank you.

[The complete prepared statement of Senator Sanford follows:]

COMPLETE PREPARED STATEMENT OF SENATOR TERRY SANFORD

Senator SANFORD. Thank you, Mr. Chairman and I would like to thank our distinguished witnesses for being with us this morning. Despite the fact that events in the Persian Gulf have captured the attention and thoughts of most everyone in this room, it is important that we, at least for a few hours this morning, turn our attention to some urgent domestic matters affecting many institutions and our economy here at home.

This morning we must turn again to the painful subject of the Resolution Trust Corporation and the aftermath of the savings and loan crisis this nation has experienced. I know I join my colleagues in expressing frustration at the slow pace at which the RTC appears to be moving properties and at the general perception that decisions are not being made at the RTC on a timely basis. I remain concerned that the structure of the RTC and its Oversight Board may be overly cumbersome, involving too many agencies in every decision and leaving no one with clear overall accountability for the RTC's performance.

I also join my colleagues in expressing further regret at the substantial amount of money that must be provided quickly if the RTC is to continue its efforts to resolve failed thrifts. However, I think it is crucial that we get on with this task and with restoring public confidence in our deposit insurance system.

In addition, Mr. Chairman, I am very troubled at the overall state of the economy and the implications that the recession we are experiencing will have on the RTC, the thrift industry and the banking industry as well. I am quite troubled that we may be entering a difficult spiral, in which banks and thrifts are reluctant or unable to lend money, due to capital and other constraints, and that this inability of these institutions to engage in lending leads to further contractions in the economy, which in turn causes business to contract, which then places much greater strain on the banking system and the FDIC.

We may very well be entering a period in which strong action is necessary to break this spiral. I am working on potential legislation to create a Bank Emergency Investment Corporation, which would create a Government-sponsored corporation which could make equity investments in marginally capitalized banks in order to bring greater stability and capital to our financial system and hopefully allow us to break the difficult cycle. I must note, however, than any such efforts to push capital into the banking system will only be effective in the long run if we are able to enact fundamental reforms to our deposit insurance system that permit early intervention into failing institutions and which remove some of the barriers to consolidation and competitiveness.

This committee has a great deal of work before it, and I commend your efforts, Mr. Chairman, to get us started so quickly and efficiently. The testimony this morning only serves to underscore how much worse problems in our financial system can become if we wait too long to address them. We must move quickly to give the RTC the resources and the structure it needs to finally resolve the thrift crisis and we must then move just as quickly to address the problems of our banking system. I look forward to working with you, the Members of this committee, the administration and our bank and thrift regulators to do just that.

Thank you, Mr. Chairman.

The CHAIRMAN. Well, I think we're hearing this morning a number of issues because they're all topical and they're really all quite urgent. So it's not surprising that they're being mentioned.

Senator Shelby.

OPENING STATEMENT OF SENATOR SHELBY

Senator SHELBY. Thank you. Mr. Chairman, I'm going to try to be brief; otherwise, this panel will be 3–4 hours before we've heard from them.

But I think the central question that bothers me here is how much is all this going to cost? We're going to hear from you as to how the RTC is doing. But when I go home, people say, how much is this going to cost?

I sat in this committee about 4 years ago from this table—I have to say, I don't recall any of you gentlemen saying this—but it said $15 billion was too much. We didn't need $15 billion to bail out the thrifts. Some of you might have heard that. But I heard it from right here at this table. They said, oh, no, we don't need that much money.

Well, we don't hear that any more, but we don't hear from you how much it's going to cost the American taxpayer down the road. And the American taxpayer is concerned and now they see coming behind this the banks. They're really concerned.

And all of us on this committee are concerned. I know you are. Where are we going? What's going to happen there? We could have the biggest economic demise since the Depression. Let's hope that doesn't ever happen. But you can look at the banks out there, as you do every day, and you know, so many of them are money-center banks. A lot of them are in deep trouble. The others are doing better throughout the country, the smaller banks and the regional banks. There are reasons for this.

But I hate to see people down the road come before this committee and say, gosh, it's going to take $200 billion or $500 billion to bail out the banks over on top of this.

The taxpayer doesn't understand it, doesn't want to understand it, and they look to us for some leadership. We're looking to you for some leadership.

We've got a distinguished panel here today. But I do want to hear about the RTC, but you can't forget the big picture or the central question.

The CHAIRMAN. Very good. Senator Graham.

OPENING STATEMENT OF SENATOR GRAHAM

Senator GRAHAM. Thank you, Mr. Chairman.

In Secretary Brady's opening statement, when we get to that, he will commence with a sentence that says:

> The Oversight Board's most important objective is to impress on the committee the urgent need for additional loss funds so the RTC can continue to resolve failed thrift institutions.

I suggest that that objective is the consequence of a more fundamental policy issue. And the policy issue is should the RTC continue to hold assets, waiting for a more favorable economic or market circumstance in which to sell, or should the RTC's policy be an aggressive one of disposition of its existing assets using the proceeds of those dispositions to meet its cash needs?

To me, that's the basic policy that today's decision forces us to examine.

I tend to agree with my Teutonic cousin, Senator Gramm of Texas, in favor of a policy of aggressive disposition. I believe that as long as the RTC holds assets, there will be a depletion of value, there will be a denial to the market of those resources, and there will be an unsettling cloud over the economic future of the country.

So as we get into this discussion, I believe we need to come to grips with that fundamental policy question and, at least for myself, I must be convinced that what I see as a policy of delay is the most appropriate one for the RTC and for the American economy.

Thank you.

OPENING STATEMENT OF SENATOR DIXON

The CHAIRMAN. Thank you. Senator Dixon.

Senator DIXON. Well, Mr. Chairman, we're here this morning to hear about the thrift problem and how we're going to clean up the mess. I've given you a statement. I'd appreciate your putting it in the record.

But like a number of my colleagues here, I would like to make these observations, that I think the important question here is can we learn from our past experiences in the thrift crisis and deal in a fundamentally sensible way with the commercial banking crisis that I think every one of us sees unfolding?

I simply want to say to my distinguished friends on the witness panel and to my colleagues on the committee that I'm going to introduce legislation tomorrow, much of which is legislation that I had pending in the past session of the Congress, and some here visited with me about that. Mr. Secretary, I visited a good deal with Bob Glauber at Treasury about my thoughts and I know the administration's thoughts.

But I will introduce legislation tomorrow, first of all, that provides for risk-based deposit insurance. I think that is a fundamental answer to one of our problems, setting up a method where the private insurance sector can take part of the percentage of the FDIC fund and establish basis points for a rate which can be extrapolated through the whole system.

I think that will work and I have suggested to many in Treasury and to the administration that this is an idea that I hope we can consider this year. My legislation will provide for mandatory annual examinations of financial institutions, all of them. And I think everybody agrees that one of the fundamental problems that brought us to this place is the lack of adequate examinations at some times in the past.

We deal with the too-big-to-fail doctrine in my legislation, providing for a haircut instead of an entire assumption of the risk.

We authorize and direct and mandate regulators to close the banks at zero-net-worth. And of course, we also modify Glass-Steagall, give additional powers to financial institutions so they can become competitive in the market place, given commercial paper, debt equity, and all of the things that I think are fundamentally sound ideas, I think with appropriate firewalls to make our American financial institutions competitive.

I just want to conclude by saying this. I'm very much interested in hearing what we do with the problem that we have now. That's a problem obviously we have to deal with.

But I hope men and women of goodwill of both political persuasions on this committee, in the majority party and in the administration will work together this year to give us good, sound legislation to address the banking problem so that we don't have to spend years hereafter dealing with cleaning up that mess as well.

If we can have the one fundamental characteristic stressed here, that we've learned from the past mistakes and we want to do something about it this year to prevent future ones, then I think it's been a valuable day for us here and it will be a valuable year for us in the Congress.

I consider, Mr. Chairman, that to be the number one domestic issue, other than the problems we face in the Persian Gulf, and I would appreciate very much the consideration of my colleagues in connection with the legislation that I'm introducing and would urge that we work closely with the administration to address the problem.

[The complete prepared statement of Senator Dixon follows:]

COMPLETED PREPARED STATEMENT OF SENATOR ALAN J. DIXON

Senator DIXON. This morning's hearing is the Senate Banking Committee's first legislative hearing of the 102nd Congress, a Congress that I hope will enact banking reform legislation of historic proportions.

Part of the impetus for such reform legislation is the savings and loan debacle that we took initial steps to address in the 101st Congress. We are here today to examine the progress, or lack thereof, that the Resolution Trust Corporation has made in resolving the S&L crisis. And we are here to understand the administration's request for additional RTC funding.

I had raised a number of concerns last year over the RTC's activities. First, the administration did not submit quite a number of significant appointments until 6 and 7 months after FIRREA became law. Second, the pace of thrift resolutions and asset dispositions was disappointing, particularly for the first 6 to 9 months of the RTC's existence. Third, the subsequent increase in RTC asset sales related predominantly to sales only of easily marketable assets and did not include real estate. As of June 30, 1990, only $248 million out of a portfolio of $6.3 billion in receivership real estate had been sold. By September 30, 1990, the RTC had collected a total of $3.3 billion from the sale of conservatorship and receivership real estate, but by December 1990 its inventory had increased to almost $20 billion of real estate.

Last year, I also raised concerns about proper resolution cost estimates, about the need for aggressive efforts to prosecute fraud and bring civil liability suits, and about the questionable nature of the 1988 FSLIC deals.

As we start this new Congress, unfortunately, all of these old concerns remain. Last week, the RTC announced a structural and geographic reorganization and took over responsibility for renegotiating the 1988 FSLIC deals. What prompted these changes and how are things expected to improve?

The RTC's second report on the 1988 deals contains troubling information about irregularities in the bidding and negotiating process. It concludes that the southwest plan resolutions "did not provide the same opportunitites for all potential bidders to compete on a fair and equitable basis." I want to know what steps the RTC intends to take as a result of this report.

As strongly as I feel about these 1988 deals and the other concerns I have raised, the most immediate question before us today relates to funding. What would be the price of not providing the RTC with additional funding? Once we have addressed that issue, I hope that the committee will move aggressively to deal with additional reforms needed to the RTC.

The CHAIRMAN. I might say on that point, we intend to do exactly that and we will work together with the administration and we

will work together as a committee as a whole as we've done previously.

I'd make just two final comments and then go to Secretary Brady.

I want to take note of the fact that last June, this committee held public hearings on whether or not we were experiencing a credit crunch. We had a number of witnesses in. I recall that there was a division of opinion within the administration. Secretary Kemp and Secretary Mosbacher at that time felt that there was a credit crunch.

I mean, you're nodding in the affirmative there, and there were others who thought not.

Now this is now over 6 months ago, 8 months ago. I don't think there's much doubt about it today. At least we can talk about what the component parts of why there is credit difficulty and certainly in some parts of the country. But I don't think there's much doubt that there is that condition out there, whatever its origins and a mixture of factors.

We're not here to discuss that primarily today, but before the session ends, because we do have the head of the Federal Reserve Board with us today, I will address a question to you and solicit a comment in that area because I think it is profoundly relevant and it's been raised by a number of Members today, so you can anticipate that.

Secretary Brady, as you begin, when we got together on the FIRREA legislation at the beginning, we sort of worked closely hand-in-glove coming down the track to get this together.

I remember initially, as you will, too, the initial projection was that $50 billion, what was asked for and thought was needed to deal with this savings and loan problem. That was the amount that was in the request that you made on behalf of the President and that's the amount that we provided.

We had some doubt at that time that that was enough and we had some discussion and it's all a matter of record about that concern at the time.

My current sense is that, because you're back asking for the money, the additional money that you need, and you'll outline that today, that the current projection of what this is likely to cost is somewhere, and we can't foresee it all because we're not through it all, but based on what's been spent to date and what can be foreseen, that we're probably looking at a cost that's somewhere between $100 and $150 billion, and maybe higher than that.

And I'm sort of posing that as a rhetorical question to you because in your request today, I'd like you to give us your best accounting as to how much has been spent to date and what it looks like is going to be needed to finish this problem off, recognizing that that's still out in front of us and you can't make a precise projection.

But I'd like you to give us the best estimate you can in that area and I'd like you to proceed at this time.

STATEMENT OF NICHOLAS BRADY, CHAIRMAN, OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION, SECRETARY, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Secretary BRADY. Thank you, Mr. Chairman. My statement is foreshortened from the written testimony, but it's plenty long enough. However, part of this appearance before your committee is the semi-annual report on the FIRREA legislation and the operations of the two units mandated thereunder. So I apologize ahead of time, but it does contain elements of that report.

We look forward to being able to bring you up-to-date on the progress being made by the RTC and the Oversight Board under the FIRREA legislation.

I appear today in my role as Chairman of the Oversight Board of the RTC. Accompanying me are the four other members of the Board: Alan Greenspan, Chairman of the Federal Reserve Board; Philip Jackson, Jr., former member of the Federal Reserve Board and currently adjunct professor at Birmingham Southern College; Jack Kemp, Secretary of Department of Housing and Urban Development; and Robert Larson, Vice Chairman of the Taubman Company and chairman of the Taubman Realty Group.

Messrs. Larson and Jackson are the appointees to the Oversight Board from the private sector.

Also accompanying me is Peter Monroe, who is President of the Oversight Board.

We are here today to discuss the RTC's funding needs, as well as other issues that FIRREA requires for this semi-annual appearance.

My most important objective today, Mr. Chairman, is to state to the committee as strongly as I can the need for additional funding by the RTC. If the RTC is to continue to carry out its congressionally-assigned mission of resolving hundreds of failed institutions and paying off their depositors without delay, then it must have additional funds as soon as possible.

If the RTC fulfills its goals for January and February and does not receive additional funds, it will have expended all available loss funds and it will be forced to stop closing and selling institutions by the end of February.

It is worth repeating that these funds are needed to protect the savings of depositors. Without these funds, RTC would have no alternative but to practice forebearance; that is, leave insolvent institutions open to continue to lose money for which the taxpayers will ultimately be liable.

RTC has estimated that forebearance for even one more quarter would cost the American taxpayers between $750 and $850 million. These cost estimates are explained in Appendix 1 to this testimony. This projected cost of $750 to $850 million is in addition to the $250 to $300 million already lost due to inaction last fall. This would bring the total cost of delay, if we don't act, to over $1 billion.

Therefore, I join with Congress in urging that we act on this request with dispatch.

How much will be required? Well, based on the RTC's draft operating plan for the 9-month period beginning January 1991, through the end of this fiscal year, and assuming funds are provided by the

Congress, the RTC projects it can complete approximately 225 additional resolutions with $145 billion in assets. To carry out the draft 9-month plan would require added loss funds of $30 billion through the end of the fiscal year 1991.

However, for a number of reasons, we should consider whether our actions should be limited just to this year's fiscal needs. For one thing, the RTC may be able to exceed expectations and resolve more than its 225 institutions. And together, we have already said to the public that the Government will do what it needs to do to protect depositors.

Insolvent institutions already have incurred losses funded primarily by insured deposits. Therefore, when these institutions are sold or closed, cash is needed to pay the difference between their deposit liabilities and the value of their assets.

The fact is that this is not a discretionary matter. If we do not act, depositors will be left hanging.

Therefore, we believe the most sensible and appropriate way for Congress to address the funding issue is to provide RTC with the full funding necessary to get the whole job done. Such funding would allow RTC to pursue its mandate aggressively and without costly interruption.

It should be noted that Congress can responsibly provide such full funding without diminishing its authority to oversee the clean-up process. The RTC and the Oversight Board appear before Congress regularly and submit annual and semi-annual reports.

I am afraid that if Congress imposes on itself the burden of repeated votes on funding, the result will be a start-and-stop clean-up process that produces further delays, substantial additional cost to taxpayers, and confusion and fear in the minds of depositors.

In June, 1990, at our semi-annual appearance, we estimated that the final cost of the S&L clean-up would be in the range of $90 billion to $130 billion in 1989 present value terms.

As we explained at the time, the actual cost is subject to a great deal of uncertainty—the number of cases, losses on assets, changes in interest rates, the condition of the real estate markets, and of course, the general condition of the economy.

Now the economy has entered a downturn and the crisis in the Persian Gulf has increased the hesitance of potential buyers to make investment commitments. All these factors are interrelated and make predictions extremely hazardous.

Although the most likely cost scenario has probably moved to the higher end of our original range, it nevertheless remains within that range.

In other words, we still believe that the upper end of the range estimate of $130 billion in 1989 present-value terms remains valid. However, as has been mentioned numerous times, no one can guarantee any estimate based on such volatile variables.

We will continue to monitor this situation closely and make known any changes that might need to take place.

Our loss estimates are based on a cashflow model that permits us to vary a number of assumptions to take into account their effect on RTC's ultimate costs. This range is based on the resolution of from roughly 700 to just under 1,000 thrifts. A more detailed expla-

nation of our methodology can be found in appendix II to this testimony.

Given the size and complexity of the problem with which we are dealing, the Board believes that the RTC has made progress.

When President Bush announced his proposed solution to the S&L crisis soon after taking office, he established four principles which continue to guide us.

First, protect the insured deposits of the millions of men and women who acted in trust by putting their savings in federally-insured savings and loans.

Second, restore the safety and soundness of the savings and loan industry so that a similar crisis cannot reoccur.

Third, clean up the S&L overhang so that we can get the problem behind us and do it at the least cost to the taxpayer.

Finally, aggressively pursue and prosecute the crooks and fraudulent operators who helped create the problem.

Mr. Chairman, FIRREA gave RTC day-to-day operational responsibility to resolve insolvent thrifts and sell assets. The Oversight Board's responsibility is to set overall strategy, policy and goals for the RTC, approve funding, and provide oversight.

Let me now turn to matters that are required by law to be addressed in our semi-annual report and other matters of interest to this committee.

From its inception on August 9, 1989, through December 31, 1990, the RTC seized 531 thrifts and resolved 352 of them. That left the RTC as of January 1, 1991, in control of 179 conservatorships.

The RTC has achieved its resolution pace by setting and achieving goals. For example, for the 3-month period ended June 30, 1990, the RTC's goal was the resolution of 141 institutions. The RTC actually resolved 155. During the next quarter, the RTC's goal was the resolution of 77 institutions and it achieved 80 such resolutions.

For the 6 month period from October 1, 1990, to March 31, 1991, the RTC is expected to resolve 192 thrifts. As a result of congressional inaction on funding, the RTC was forced to revise its goal to resolve 97 thrifts. As of December 31, 1990, RTC has resolved 66 of its revised goal and expects to meet its goal of 97 institutions by the end of February.

Last summer, the RTC began a pilot project called the Accelerated Resolution Program—acronym ARP—to lower the cost of thrift resolutions by preselling troubled institutions before they are put in conservatorship. Such presales should reduce the deterioration in franchise value and core deposits that can result from placing an institution in conservatorship.

Nine institutions were selected for the ARP pilot project. Sales have closed on seven of these nine institutions and the OTS and the RTC have begun a review of this demonstration program. Some valuable information has already been learned.

In all nine thrifts, there has been virtually no deposit run-off. Management has remained intact and the institutions have remained stable.

OTS has begun to review its group IV thrifts—these are the worst thrifts—to identify candidates for the next phase of the program should the RTC Oversight Board approve expansion beyond

the pilot project. The Board's decision will depend on the RTC's evaluation of the project.

As of January 1, there were 179 thrifts left in conservatorship. The most likely candidates for new conservatorships are in OTS's group IV, which also contained 179 thrifts. There are 356 thrifts in OTS's group III, for which the future is uncertain.

The advantages of placing an institution in conservatorship are that the RTC can stem losses, stabilize the institution, and halt practices which have contributed to insolvency. Conservatorship also helps the RTC prepare the institution for resolution by reducing its assets by means such as securitization and by reducing the institutions' high cost deposits.

The disadvantage of the conservatorship is that the conservatorship can contribute to an erosion of franchise value. Skilled staff often begin to leave in anticipation of a possible liquidation of the institution, and depositors tend to accelerate their withdrawal of funds. The Accelerated Resolution Program is intended to avoid these disadvantages.

In addition to resolving insolvent institutions, the RTC must dispose of their assets, whether in conservatorship, at resolution, or out of receivership. From its inception through December 31, 1990, the RTC has seized thrifts with over $273 billion in initial assets. Through a combination of resolutions, asset sales and note collections, it has reduced assets by over $127 billion and continues to hold assets of about $146 billion.

Even though RTC has made progress, the Oversight Board and RTC are concerned that RTC has not been able to sell more assets. Therefore, the Oversight Board over the past 6 months has focused on developing policies such as securitization, seller financing and affordable housing, that should enable the RTC to accelerate asset sales.

At our Board meeting last week, however, Chairman Seidman told us that there is a new roadblock that will further delay asset sales. The RTC Board has been advised that potential personal liabilities may be imposed upon directors and officers and employees of the RTC, and the Oversight Board, in connection with the RTC's securitization program, as well as in connection with RTC's other asset disposition activities.

Chairman Seidman indicated that a legislative solution to the problem is needed and that his staff is currently drafting proposed legislation to address this matter.

The administration is reviewing this issue carefully.

FIRREA mandates that the RTC make maximum delegation of asset management and sales functions to the private sector. To implement that, the RTC has adopted a Standard Asset Management and Disposition Agreement, or SAMDA program.

Under SAMDA, private sector contractors will be paid fees for managing the properties, as well as incentives to accelerate sales and maximize the return to the RTC.

While these contracts provide fair returns for property management, the incentive fees will be given for turning properties into cash rather than encouraging managers to collect their management fees while they wait for the real estate markets to improve.

Minority outreach.

The RTC Minority and Women Outreach Program seeks to encourage minority participation in the award of RTC contracts. As of November, 1990, RTC informs us that over 3500 minority-owned firms, over 4500 majority women-owned firms, and approximately 900 minority women-owned firms were registered as potential asset managers, brokers, lawyers and other RTC contractors. Over 900 contracts for such work, or about 20 percent of the total awards, have been awarded to minority and women-owned businesses.

FIRREA also directs the RTC to give preference in purchasing thrifts to bids from investors with the same ethnic identification as that of the failed thrift. As of November, the RTC has resolved 14 minority-owned institutions. Three were liquidated, eight were acquired by buyers of the same ethnic identification, and three were sold to other buyers.

Let me say a few additional words about some enforcement tools.

As you know, in June 1990, President Bush announced a package of legislative and administrative initiatives designed to intensify the fight against fraud in our nation's financial institutions. Most of these legislative initiatives were embraced in a bipartisan manner by the Congress and enacted as the Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990.

The new law provides an array of additional powers to the Justice Department, bank regulators, and to the FDIC and RTC.

In conjunction with the authorities provided in FIRREA, we now have an effective arsenal of legal weapons available to combat fraud and to recover assets. Using these authorities, Federal law enforcement agencies are gaining ground against fraudulent thrift officials.

Of 566 defendants charged in savings and loan cases, from October 1988 through the end of 1990, 403 have been convicted and only 18 acquitted. Prison sentences have been dealt totaling 768 years and $231 million in restitutions have been ordered.

Of those convicted, substantial numbers have been savings and loan chief executive officers, chairmen, presidents, directors, and other officers.

Now let me turn to the recent areas of Oversight Board activity. First, I will discuss the importance of asset sales and three Oversight Board actions in this area: securitization, seller financing, and affordable housing.

Next, I will describe the Oversight Board's developing oversight and evaluation role, including its management planning procedures and the relationship between the Board and the RTC Inspector General.

Finally, I will describe the Board's role in developing policy for restructuring the 1988 deals.

As I said earlier, the increased number of resolutions handled by the RTC makes it very important to accelerate asset sales. Our goals are to increase both the sales pace and the return on asset sales. Acquisitions of this inventory are funded by working capital borrowed by the RTC from the Federal Financing Bank. These borrowings grew to $53 billion by December 31st, 1990, and are projected to reach $76 billion in February. The RTC estimates they may increase to over $100 billion by the end of Fiscal Year 1991.

In developing asset sales policies, the Oversight Board received valuable advice from the National Advisory Board and the six regional boards established by FIRREA.

The Oversight Board recently directed the RTC to increase its use of securitization as a means to speed the sale of performing financial assets. Securitization means the pooling of financial assets with a positive cashflow and converting the pool into one or more securities collateralized by the assets in the entire pool.

The policy applies to all securitizable financial assets held by the RTC, including mortgage loans, high-yield securities, and any loans originated by the RTC under seller financing.

Approximately 25 percent of all RTC assets are securitizable. The Board believes that securitization should aid the RTC to sell these assets more quickly, thus improving its cashflow position. This, in turn, should materially lessen the pressures for working capital borrowings through the Federal Financing Bank. Progress in the securitization area depends on the personal liability protection I mentioned earlier.

While securitization is one method to help the RTC sell its performing financial assets, the RTC has informed the Board that certain financial assets, as well as real estate and delinquent mortgages, are not securitizable and cannot be sold because commercial financing is not available.

Accordingly, in December, the Oversight Board expanded its seller financing policy to provide the RTC greater flexibility in its assets sales program.

This program provides $7 billion in seller financing authority for assets that cannot be sold at acceptable market prices because of inadequate commercial financing. As a result of such sales, the RTC generally will receive an additional 15 percent downpayment and receive the balance in installments over time. If buyers in such sales do not fulfill their commitments, the RTC still comes out ahead. It keeps the 15 percent downpayment. It may have also received a number of installment payments, it has shifted the asset's operating cost to the private sector for a time, and it will repossess the asset if necessary.

It is important to remember that the RTC has already paid for these assets, so that the sale can only reduce Treasury borrowings.

Importantly, under this policy, a minimum of $250 million is reserved solely for the financing of affordable housing to qualified low- and moderate-income buyers.

I would also like to address briefly the issue of the RTC's environmental responsibilities which have received some press coverage recently.

FIRREA requires the RTC to identify properties with natural, cultural, recreational, or scientific significance. However, the FIRREA conference report made clear that this reporting provision was not intended to impose any duty with respect to such properties or create any liabilities for the RTC in connection with such properties.

The Oversight Board felt that it was inappropriate to delegate the principal responsibility for this important identification function to any single other public or private institution. Rather, it was the Board's judgment that the RTC should address this issue

through a strengthened internal identification capacity, combined with a procurement where appropriate on a case-by-case basis of the best available services from both the public and private sectors. Appropriate agencies would include the Fish and Wildlife Service, the Army Corps of Engineers, the National Park Service, the EPA, and many other private and public sector agencies.

I assure you that the Oversight Board intends that the RTC fully comply with the important identification function consistent with the best sales methods for properties.

Chairman Seidman has imposed a new program to sell to eligible buyers during the clearinghouse period the bulk of RTC's single-family affordable housing in a no-reserve auction and sealed-bid process. We have requested Chairman Seidman to provide more information on this initiative which the Oversight Board clearly supports in principle and thinks is extremely important.

The Oversight Board has also approved a policy allowing the RTC to accept offers from qualified buyers for single-family property at prices as low as 80 percent of their market value. The policy augmented an active RTC program to increase the opportunities for low- and moderate-income buyers who are at or below 80 percent of the local median income.

I have already mentioned the minimum amount of $250 million in seller financing which the Oversight Board has made available to the affordable housing program. The Oversight Board previously authorized the RTC to pay up to $6 million to purchase forward mortgage revenue bond commitments to be exclusively reserved for the RTC affordable program.

One hundred eighty-nine million dollars has already been reserved under this program which, when combined with the $250 million revolving affordable seller financing program, provides a minimum of $439 million of financing for affordable housing.

As a result of these new developments and the growing experience of the program and staff, we can report that the property sales have increased. Through December 31, 1990, the program had accepted approximately $108 million of contracts on 2,737 properties. Of these, 1,507 properties had closed.

The average sales price was $38,442 for single-family homes and $936,000 for the 9 multifamily developments on which the RTC has accepted offers. RTC advises that the average income of purchasers under the Affordable program is less than 80 percent of the national median income.

Under the Oversight Board's management planning procedures, the RTC is asked to set goals which it believes are attainable. This assures that the RTC management is committed to achieving these goals. The Board then evaluates the RTC's performance against the goals.

For example, the Board has suggested improvements in RTC planning and performance measurement through the operating plan process. As mentioned earlier, the Board and RTC are working to develop a final operating plan for fiscal 1991, rather than the 3 month plans which were previously submitted. Longer planning periods more accurately reflect the time horizon needed by the RTC for proper goal setting.

The operating plan process provides a vehicle for setting program goals and also funding needs. Funding needs for both loss funds and working capital are constantly updated for the Board and compared to statutory constraints.

In the area of accounting, the Oversight Board's CPA, as well as the Inspector General, are reviewing the loss recognition process used by the RTC. While the Board has received the RTC's unaudited financial statements for the period ending December 31, 1989, the Board continues to press the RTC for audited financial statements covering this period.

As part of the Board's responsibility to attempt to eliminate potential fraud, waste and abuse in RTC operations, it has been working closely with the RTC Office of Inspector General to set an aggressive audit and investigation agenda.

The IG has opened 15 investigative cases and closed 6 to date. It has begun 15 audits and issued 6 reports. It has identified 36 major areas on which it is planning to focus in fiscal year 1991.

Currently, at the level of 100 people, the IG plans a staff of about 350 by fiscal year 1992. In addition, at the Board's direction, the IG has provided the Board its detailed audit and investigation plan for the balance of this fiscal year.

In September, the RTC reported to the Oversight Board on its FIRREA-mandated review of the assistance transactions entered into by the Federal Savings and Loan Insurance Corporation, FSLIC, prior to the passage of the FIRREA legislation. From its review, the RTC concluded that a restructuring of some of the so-called "88 Deals" could result in savings of approximately $2 billion to the taxpayers over the terms of the loans, but that it would require a current appropriation of approximately $20 billion to achieve these savings.

On October 18, Congress appropriated $22 billion for the FSLIC resolution fund to pay obligations arising in Fiscal 1991, as well as, and I quote:

> To permit the prepayment of certain higher interest rate obligations and thus realize a savings of approximately $2 billion.

The Oversight Board has adopted a policy statement to guide the RTC in restructuring the FSLIC Assistance Agreements, which is appended to this testimony as Appendix IV.

The important point is that we must immediately begin the restructuring process and use this fiscal year's appropriations to save taxpayer dollars.

In closing, let me reiterate what we said at the beginning of the statement. The job is getting done, but we still have a long way to go. This is a task the Government cannot escape if we are to honor our promise to the American people to make good on Federal deposit insurance.

Immediate congressional action to provide additional funds is essential. I repeat, that without such action, the RTC's resolution process will halt and the taxpayers' cost will increase.

As discussed earlier, we believe the most sensible and appropriate way for Congress to address the funding issue is to provide the RTC with permanent funding necessary to get the whole job done.

Let me say again that without permanent funding, the result could be a stop-and-start clean-up process that produced further delays, realizes substantial additional costs to the taxpayers, and adds to the confusion and fear in the minds of depositors.

We will be glad to answer any questions you might have. And Mr. Chairman, I would like to have your agreement to have the rest of my testimony appended to the record.

The CHAIRMAN. Without objection, so ordered.

[The complete statement of Secretary Nicholas F. Brady follows:]

EMBARGOED UNTIL GIVEN
EXPECTED AT 10:00 A.M.
JANUARY 23, 1991

STATEMENT OF HONORABLE NICHOLAS F. BRADY
Chairman, Oversight Board of the
Resolution Trust Corporation
before the
Senate Committee on Banking, Housing and Urban Affairs
January 23, 1991, 10:00 a.m.
538 Dirksen Senate Office Building

Mr. Chairman, Members of the Committee, we are pleased to be making our semiannual appearance before your Committee today. We look forward to bringing you up to date on the progress being made by the Resolution Trust Corporation (RTC) and the Oversight Board under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA).

I appear today in my role as Chairman of the Oversight Board of the RTC. Accompanying me are the four other members of the Board: Alan Greenspan, Chairman of the Federal Reserve Board, Philip Jackson, Jr., former member of the Federal Reserve Board and currently adjunct professor at Birmingham Southern College, Jack Kemp, Secretary of the Department of Housing and Urban Development, and Robert Larson, Vice Chairman of the Taubman Company and Chairman of the Taubman Realty Group. Also accompanying us is Peter Monroe, who is President of the Oversight Board.

We are here today to discuss RTC's funding needs as well as other issues that FIRREA requires for this semi-annual appearance.

RTC'S FUNDING NEEDS

Mr. Chairman, my most important objective today is to state to the Committee as strongly as I can the need for additional funding for the RTC. If the RTC is to continue to carry out its Congressionally assigned mission of resolving hundreds of failed institutions and paying off their depositors without delay, then it must have additional funds as soon as possible. If the RTC fulfills its goals for January and February, and does not receive additional funds, it will have expended all available loss funds and it will be forced to stop closing and selling institutions by the end of February.

It is worth repeating that these funds are needed to protect the savings of depositors. Without these funds, RTC would have no alternative but to practice forbearance, that is, leave insolvent institutions open to continue to lose money for which the taxpayers will ultimately be liable. RTC has estimated that forbearance for even one more quarter would cost the American taxpayers $750-$850 million. (These cost estimates are explained in Appendix I). This projected cost is in addition to the $250 to $300 million already lost due to inaction last fall. This would bring the total cost of delay to over $1 billion.

Therefore, I urge the Congress to act on funding with dispatch.

How much will be required? Based on the RTC's draft operating plan for the nine-month period beginning January, 1991, through the end of this fiscal year, and assuming funds are provided by Congress, the RTC projects it can complete approximately 225 additional resolutions with $145 billion in assets. To carry out the draft nine-month plan would require added loss funds of $30 billion through the end of fiscal year 1991.

However, for a number of reasons, we should consider whether our actions should be limited just to this fiscal year's estimated needs. For one thing, the RTC may be able to exceed expectations and resolve more than its goal of 225 institutions. And together we have already said to the public that the government will do what it needs to do to protect depositors.

Insolvent institutions already have incurred losses funded primarily by insured deposits. Therefore, when these institutions are sold or closed, cash is needed to pay the difference between their deposit liabilities and the value of assets assumed by the institutions. The fact is that this is not a discretionary matter. If we do not act depositors will be left hanging.

Therefore, we believe the most sensible and appropriate way for Congress to address the funding issue is to provide RTC with the permanent funding necessary to get the whole job done. Such funding would allow RTC to pursue its mandate aggressively and without costly interruption. It should be noted that Congress can responsibly provide such permanent funding without diminishing its authority to oversee the clean-up process. The RTC and the Oversight Board appear before Congress regularly and submit annual and semiannual reports.

I am afraid that if the Congress imposes on itself the burden of repeated votes on funding, the result will be a start and stop cleanup process that produces further delays, substantial additional costs to taxpayers, and confusion and fear in the minds of depositors.

In June, 1990, at our semi-annual appearance, we estimated that the final cost of the S&L cleanup would be in the range of $90 to $130 billion in 1989 present value terms. As we explained at the time, the actual cost is subject to a great deal of uncertainty -- the number of cases, losses on assets, interest rates, the condition of real estate markets, and the general condition of the economy. Now, the economy has entered a downturn and the crisis in the Persian Gulf has increased the hesitance of potential buyers to make investment commitments. All these factors are interrelated and make predictions hazardous.

Although the most likely cost scenario has probably moved to the higher end of our original range, it nevertheless remains within that range. In other words, we still believe that the upper-end-of-the range estimate of $130 billion in 1989 present value terms remains valid. However, as has been mentioned numerous times, no one can guarantee any estimate based on such volatile variables. We will continue to monitor this situation closely.

Our loss estimates are based on a cash flow model that permits us to vary a number of assumptions to take into account their affect on the RTC's ultimate costs. This range is based on the resolution of from roughly 700 to just over 1000 thrifts. A more detailed explanation of our methodology can be found in Appendix II to this testimony.

RTC WORK IN GETTING THE JOB DONE

Given the size and complexity of the problem with which we are dealing, the Board believes that the RTC has made progress.

When President Bush announced his proposed solution to the savings and loan crisis soon after taking office, he established four principles which continue to guide us.

- First, protect the insured deposits of the millions of men and women who acted in trust by putting their savings in federally insured savings and loans.
- Second, restore the safety and soundness of the savings and loan industry so that a similar crisis can not reoccur.
- Third, clean up the S&L overhang so we get the problem behind us, and do it at the least cost to the taxpayer.
- Finally, aggressively pursue and prosecute the crooks and fraudulent operators who helped create the problem.

Mr. Chairman, FIRREA gave RTC day-to-day operational responsibility to resolve insolvent thrifts and sell assets. The Oversight Board's responsibility is to set overall strategy, policy and goals for the RTC, approve funding, and provide oversight. Let me turn now to matters that are required by law to be addressed in our semi-annual report, and other matters of interest to the Committee.

As required by FIRREA, our testimony will cover the six-month period from April 1 through September 30, 1990. In addition, we will report on some of the key events occurring since the end of that reporting period. My presentation is supplemented by a more detailed response, contained in Appendix III, to several of the specific information requirements set forth in FIRREA for this semiannual appearance.

Progress in Resolutions

From its inception on August 9, 1989, through December 31, 1990, RTC seized 531 thrifts, and resolved 352 of them. That left the RTC, as of January 1, 1991, in control of 179 conservatorships.

The RTC has achieved its resolution pace by setting and achieving goals. For example, for the three month period ending June 30, the RTC's goal was the resolution of 141 institutions. The RTC actually resolved 155. During the next quarter, the RTC's goal was the resolution of 77 institutions and it achieved 80 resolutions.

For the 6-month period from October 1, 1990, to March 31, 1991, the RTC had expected to resolve 192 thrifts. As a result of Congressional inaction on funding, RTC was forced to revise its goal to resolve 97 thrifts. As of December 31, 1990, RTC had resolved 66 of its revised goal, and expects to meet its goal of 97 institutions by the end of February.

The New Accelerated Resolution Program (ARP)

Last summer the RTC began a pilot project, called the Accelerated Resolution Program (ARP), to lower the cost of thrift resolutions by pre-selling troubled institutions before they are put in conservatorship. Such pre-sales should reduce the deterioration in franchise value and core deposits that can result from placing an institution in conservatorship. ARP is a cooperative effort between the RTC and the Office of Thrift Supervision (OTS) in which the OTS, in consultation with the RTC, identifies which thrifts are ARP candidates. Then the OTS and RTC establish a supervisory and regulatory framework within which the institutions will operate while in ARP.

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Nine institutions were selected for the ARP pilot project. They were chosen on the basis of: 1) bidder interest, 2) management-led investor proposals, and/or 3) demonstrated franchise value. The OTS and RTC selected thrifts in different geographic areas and of varying sizes ranging from $100 million to more than $3 billion in assets.

In order to ensure open and competitive bidding, the standard RTC bidding process has been followed. As a result, more than 1,300 potential bidders from the RTC qualified bidders list were notified by mail for each of the nine thrifts.

Sales have closed on seven of the nine institutions, and the OTS and RTC have begun a review of this demonstration program. Some valuable information already has been learned. In all nine thrifts, there has been virtually no deposit runoff, management has remained intact, and the institutions have remained stable.

OTS has begun to review its Group IV thrifts to identify candidates for the next phase of the program should the RTC Oversight Board approve expansion beyond the pilot project. The Board's decision will depend on the RTC's evaluation of the pilot project.

Status of the RTC Conservatorship Program

As of January 1, there were 179 thrifts in conservatorship. In addition, the most likely candidates for new conservatorships are in OTS's Group IV, which also contained 179 thrifts. There are another 356 thrifts in OTS's Group III for which the future is uncertain.

The advantages of placing an institution in conservatorship are that the RTC can stem losses, stabilize the institution, and halt practices which may have contributed to insolvency. Conservatorship also helps the RTC prepare the institution for resolution by reducing its assets by means such as securitization and by reducing the institution's high cost deposits. The disadvantage of conservatorship is that conservatorship can contribute to an erosion of franchise value. Skilled staff often begin to leave in anticipation of a possible liquidation of the institution, and depositors tend to accelerate their withdrawal of funds. The Accelerated Resolution Program is intended to avoid these disadvantages.

Progress in Asset Disposition

In addition to resolving insolvent institutions, the RTC must dispose of their assets, whether in conservatorship, at

resolution, or out of receivership. During the April through September period covered by our semi-annual report, receivership and conservatorship assets were reduced by $66.8 billion in book value.

However, from its inception through December 31, 1990, the RTC has seized thrifts with over $273 billion in initial assets. Through a combination of resolutions, asset sales and note collections, it has reduced assets held by over $127 billion, and continues to hold assets of about $146 billion.

Even though RTC has made progress, the Oversight Board and RTC are concerned that RTC has not been able to sell more assets. Therefore, the Oversight Board has over the past six months focused on developing policies - securitization, seller financing and affordable housing - that should enable the RTC to accelerate asset sales.

At our Board meeting last week, however, Chairman Seidman told us that there is a new road block that will further delay asset sales. The RTC Board has been advised that potential personal liabilities may be imposed upon directors, officers, and employees of the RTC and the Oversight Board in connection with the RTC's securitization program as well as in connection with RTC's other asset disposition activities. Chairman Seidman indicated that a legislative solution to the problem is needed and that his staff is currently drafting proposed legislation to address the matter. The Administration is reviewing this issue.

RTC Use of Private Sector to Aid Asset Sales

FIRREA mandates that the RTC make maximum delegation of asset management and sales functions to the private sector. To implement that, the RTC has adopted a Standard Asset Management and Disposition Agreement, or SAMDA program.

The RTC has already placed over $10 billion in real estate and delinquent mortgages under SAMDA contracts. Bids have already been received to place another $10 billion under SAMDA. Accordingly, most REO and delinquent mortgages in receivership will soon be under SAMDA contracts. The RTC is also proceeding to place all such conservatorship assets under SAMDA contracts.

Private sector contractors will be paid fees for managing the properties as well as incentives to accelerate sales and maximize the return to the RTC. While these contracts provide fair returns for property management, the incentive fees will be given for turning properties into cash rather than encouraging managers to collect their management fees while they wait for the real estate markets to improve.

There are incentives for selling at prices equal to or greater than the RTC's estimates of recovery. There is a 20% incentive payment for selling in the first year and 10% for selling in the second year. Actual holding costs are deducted from the sales price to encourage efficient management.

We believe the program is promising, but we recognize the difficulty of selling these assets in the current real estate market.

Progress toward Minority Outreach

The RTC Minority and Women Outreach Program seeks to encourage minority participation in the award of RTC contracts. The RTC has conducted seminars throughout the country to inform minority and women owned businesses of the many contractor opportunities with the RTC and the registration and bidding process. Advertisements are placed in minority print media to publicize the program. As of November, 1990, RTC informs us that over 3,500 minority-owned firms, over 4,500 majority women-owned firms, and approximately 900 minority women-owned firms were registered as potential asset managers, brokers, lawyers and other RTC contractors. Over 900 contracts for such work, or about 20% of total awards, have been awarded to minority and women owned businesses.

FIRREA also directs the RTC to give preference in purchasing thrifts to bids from investors with the same ethnic identification as that of the failed thrift. As of November, the RTC had resolved 14 minority owned institutions; 3 were liquidated, 8 were acquired by buyers of the same ethnic identification, and 3 were sold to other buyers.

The Oversight Board continues to monitor this effort by RTC to preserve minority-owned institutions and promote greater awareness by minority and women-owned businesses of these excellent business opportunities.

ENHANCED LAW ENFORCEMENT

Let me say a few additional words about some new enforcement tools. As you know, in June 1990, President Bush announced a package of legislative and administrative initiatives designed to intensify the fight against fraud in our nation's financial institutions. Most of these legislative initiatives were embraced in a bi-partisan manner by the Congress and enacted as the Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990.

The new law provides an array of additional powers to the

Justice Department, bank regulators, the FDIC and the RTC, particularly provisions which:

- Provide authority to freeze or appoint a receiver for the assets of fraudulent operators;
- Enhance civil and criminal forfeiture authority;
- Protect victims of fraud by closing loopholes in the bankruptcy laws that have in the past enabled some executives to evade financial responsibility for their misdeeds;
- Allow the Justice Department to accept without reimbursement the services of federal attorneys, law enforcement personnel, and other employees;
- Direct U.S. courts to give cases brought by the FDIC and the RTC priority consideration and to establish procedures for expedited appeals;
- Give law enforcement authorities a needed tool: the ability to request the use of wiretaps for bank fraud and related offenses.

In conjunction with the authorities provided in FIRREA, we now have an effective arsenal of legal weapons available to combat fraud and to recover assets. Using these authorities, federal law enforcement agencies are gaining ground against fraudulent thrift officials. Of 566 defendants charged in savings and loan cases from October 1988 through the end of 1990, 403 have been convicted and only 18 acquitted. Prison sentences have been dealt totalling 768 years, and $231.8 million in restitutions have been ordered. Of those convicted, substantial numbers have been savings and loan chief executive officers, chairmen, presidents, directors, and other officers.

RECENT OVERSIGHT BOARD ACTIONS

Let me turn now to the key areas of Oversight Board activity over the last six month period. First, I will discuss the importance of asset sales and three Oversight Board actions in this area: securitization, seller financing and affordable housing. Next, I will describe the Oversight Board's developing oversight and evaluation role including its management planning procedures and the relationship between the Board and the RTC Inspector General.

Finally, I will describe the Board's role in developing policy for restructuring the 1988 Deals.

Revision of Asset Sales Strategies

As I said earlier, the increased number of resolutions handled by the RTC makes it very important to accelerate its asset sales. The Oversight Board is in the process of performing an overall strategic review of RTC asset sales programs. Our goals are to increase both the sales pace and the return on asset sales. Acquisition of this inventory is funded by working capital borrowed by RTC from the Federal Financing Bank (FFB). These borrowings grew to $53 billion by December 31, 1990, and are projected to reach $76 billion in February. The RTC estimates they may increase to over $100 billion by the end of fiscal year 1991.

In developing asset sales policies, the Oversight Board received valuable advice from the National Advisory Board and the six regional boards established by FIRREA. Because the board members know local economic conditions and are composed of community leaders in the real estate, banking, housing, legal and accounting professions, they have provided useful recommendations for the Oversight Board.

The Need for Securitization

The Oversight Board recently directed the RTC to increase its use of securitization as a means to speed the sale of performing financial assets. Securitization means the pooling of financial assets with a positive cash flow and converting the pool into one or more securities collateralized by the assets in the pool.

The policy applies to all securitizable financial assets held by the RTC including mortgage loans, high-yield securities, and any loans originated by the RTC under seller financing. Approximately 25% of all RTC assets are securitizable. The Board believes that securitization should aid the RTC to sell these assets more quickly, thus improving its cash flow position. This, in turn, should materially lessen the pressures for working capital borrowings through the FFB. Progress in the securitization area depends on the personal liability protection I discussed earlier.

The New Seller Financing Policy

While securitization is one method to help the RTC sell its performing financial assets, the RTC has informed the Board that certain financial assets as well as real estate and delinquent mortgages are not securitizable and cannot be sold because commercial financing is not available.

Accordingly, in December, the Oversight Board expanded its seller financing policy to provide the RTC greater flexibility in its asset sales program.

This program provides $7 billion in seller financing authority for assets that can't be sold at acceptable prices because of inadequate commercial financing. As a result of such sales, the RTC generally will receive an initial 15% downpayment, and receive the balance in installments over time. If buyers in such sales do not fulfill their commitments, the RTC still comes out ahead: it has the 15% downpayment, it may have received a number of installment payments, it has shifted the asset's operating costs to the private sector for a time, and it will repossess the asset if necessary. It is important to remember that the RTC has already paid for these assets so that the sale can only reduce Treasury borrowings. Importantly, under this policy a minimum of $250 million is reserved solely for the financing of affordable housing to qualifying low- and moderate-income buyers.

This $7 billion program will be measured, monitored and evaluated for effectiveness by the Oversight Board. The Board has also directed the Inspector General to perform a front end risk assessment of the program and conduct periodic audits of its implementation.

Affordable Housing

Since we last appeared before this Committee, the Oversight Board has adopted new policies regarding the Affordable Housing Disposition Program. We believe the RTC is making progress in responding to the FIRREA mandate in the area of affordable housing for moderate-and lower-income persons.

On August 15, 1990, the Oversight Board approved a final rule allowing for a number of marketing initiatives to expedite the sale of properties. The rule encourages the RTC to use bulk sales and special marketing events such as home fairs, open houses, and auctions to make qualified organizations and individuals more aware of available properties.

Chairman Seidman has proposed a new program to sell to eligible buyers during the clearinghouse period, the bulk of RTC's single family affordable housing in a no reserve auction and sealed bid process. We have requested Chairman Seidman to provide more information on this initiative which the Oversight Board clearly supports in principle.

The Oversight Board also approved a policy allowing the RTC to accept offers from qualified buyers for single family

properties at prices as low as 80% of the market value. The policy augmented an active RTC program to increase the opportunities for low- and moderate- income buyers who are at or below 80% of the local median income.

I have already mentioned the minimum amount of $250 million in seller financing which the Oversight Board made available to the affordable housing program. The RTC is establishing guidelines for the implementation of seller financing. The Oversight Board previously authorized the RTC to pay up to $6 million to purchase forward mortgage revenue bond (MRB) commitments to be exclusively reserved for the RTC affordable program. One hundred eighty-nine million dollars has already been reserved under this program which when combined with the $250 million revolving affordable seller financing program provides a minimum of $439 million of financing for affordable housing.

The Oversight Board has also encouraged the RTC to take advantage of the Federal National Mortgage Corporation's and the Federal Home Loan Mortgage Corporation's demonstrated capabilities in housing finance. Programs utilizing their expertise in structuring and servicing seller financed mortgage loans, including delegating the origination and servicing to designated lenders with prudent underwriting, are now under consideration.

As a result of some of these new developments and the growing experience of the program and staff, we can report that property sales increased. Through December 31, 1990, the program had accepted approximately $108 million of contracts on 2,737 properties, and of these, 1,507 properties had closed. The average sales price was $38,442 for single family homes and $936,000 for the nine multi-family developments on which the RTC had accepted offers. RTC advises that the average income of purchasers under the affordable program is less than 80% of national median income.

Although properties in conservatorship are by statute not subject to the 90-day marketing period, both the seller financing and MRB programs are available for conservatorship properties. The RTC is encouraging non-profit organizations, as well as individuals, to make offers for conservatorship properties.

With the final rule in place, emphasis is switching to the marketing of multi-family properties. The RTC has had some serious expression of interest in bulk packages of multi-family affordable housing and its National Sales Center is currently marketing its first bulk package of multi-family properties consisting of three Florida developments with 590 units.

One key to the progress in the affordable housing program

thus far has been the assistance of clearinghouses and technical assistance advisors. The RTC has established 30 clearinghouse agreements with state housing finance agencies including one with the Federal Housing Finance Board with the participation of the 12 district Federal Home Loan Banks.

The Board's Role in Oversight and Evaluation

Under the Oversight Board's management planning procedures the RTC is asked to set goals which it believes are attainable. This is the best way to assure that RTC management is committed to achieving these goals. The Board then evaluates the RTC's performance against the goals.

For example, the Board has suggested improvements in RTC planning and performance measurement through the operating plan process. As mentioned earlier, the Board and RTC are working to develop a final operating plan for fiscal 1991, rather than the 3 month plans submitted previously. Longer planning periods more accurately reflect the time horizon needed by the RTC for proper goal setting. The nine month plan will be monitored monthly and performance forecasts against goals will be provided quarterly together with explanations of variances from plan. RTC will be asked to submit a one year plan for fiscal year 1992.

The operating plan process provides a vehicle for setting program goals and also funding needs. Funding needs for both loss funds and working capital are constantly updated for the Board and compared to statutory constraints.

For example, with each FFB funding draw the RTC must certify to the Board that it is in compliance with all statutory funding constraints after taking into consideration all contingent liabilities -- notably "asset puts". Asset puts represent the right of thrift buyers to "put" purchased assets back to the RTC. The Board has required the RTC to provide a detailed monthly analysis of such asset puts as to amount, term and characteristics.

The RTC also must supply a weekly update of its rolling six-week schedule of anticipated FFB borrowings.

In the area of accounting, the Oversight Board's CPA as well as the Inspector General are reviewing the loss recognition process used by the RTC. While the Board has received the RTC's unaudited financial statements for the period ending December 31, 1989, the Board continues to press the RTC for audited financial statements covering this period.

As a part of the Board's responsibility to attempt to eliminate potential fraud, waste, and abuse in RTC operations, it has been working closely with the RTC Office of Inspector General to set an aggressive audit and investigation agenda.

Weekly meetings have been held with the IG on investigative and audit activities. The meetings focus on spotting areas of vulnerability and correcting problems before they occur. The IG has been directed by the Oversight Board to undertake audits in the highest risk areas. He has also been directed to audit a sample group of completed resolutions and executed contracts. As mentioned earlier, the Oversight Board has directed the IG to undertake a front end risk assessment of the seller financing program and to periodically audit it and the 1988 Deal restructurings.

The IG has opened 15 investigative cases and closed 6 to date. It has begun 15 audits and issued 6 reports. It has identified 36 major areas on which it is planning to focus in fiscal 1991. Currently at the level of 100, the IG plans a staff of about 350 by fiscal year 1992. The Oversight Board considers it essential that an aggressive auditing program be pursued. In addition, at the Board's direction, the IG has provided the Board its detailed audit and investigation plan for the balance of this fiscal year.

Progress in Renegotiating 1988 Deals

In September, the RTC reported to the Oversight Board on its FIRREA mandated review of the assistance transactions entered into by the Federal Savings and Loan Insurance Corporation (FSLIC) prior to the passage of the Act. From its review, the RTC concluded that a restructuring of some of the so-called "88 Deals" could result in a savings of approximately $2 billion to the taxpayers over the term of the loans but would require a current appropriation of approximately $20 billion.

On October 18, Congress appropriated $22 billion for the FSLIC Resolution Fund (FRF) to pay obligations arising in FY 1991 as well as "permit the prepayment of certain higher interest rate obligations and thus realize a savings of approximately $2 billion".

Under FIRREA, the Oversight Board has the responsibility to establish overall strategies, policies and goals for restructuring the 1988 FSLIC assisted transactions.

Therefore, the Oversight Board has adopted a policy statement to guide the RTC in restructuring the FSLIC Assistance Agreements (see Appendix IV). The policy statement provides a

series of guidelines for such restructurings and directs the RTC to use Treasury borrowings efficiently so as to maximize overall cost savings for the government with respect to the 1988 Deals as a whole.

The important point here is that we must immediately begin the restructuring process and use this fiscal year's appropriations to save taxpayer dollars. Accordingly, we have ordered the RTC to start negotiations consistent with this policy statement.

CONCLUSION

In closing, let me reiterate what we said at the beginning of our statement. The job is getting done, but we still have a long way to go. This is a task the government cannot escape if we are to honor the promise to the American people to make good on federal deposit insurance.

Immediate Congressional action to provide additional loss funds is essential. I repeat that without such action the RTC's resolution process will halt and the taxpayers' costs will increase. As discussed earlier, we believe the most sensible and appropriate way for Congress to address the funding issue is to provide RTC with the permanent funding necessary to get the whole job done. Let me say again that without permanent funding the result could be a start and stop cleanup process that produces further delays, substantial additional costs to taxpayers, and confusions and fear in the minds of depositors.

We will be glad to respond to your questions.

APPENDIX I

RTC
Resolution Trust Corporation

January 10, 1990

MEMORANDUM TO: Peter H. Monroe
President, RTC Oversight Board

FROM: David C. Cooke
Executive Director

SUBJECT: Cost of Delaying Resolutions

You have asked that we update our memorandum of November 1, 1990 on the cost of delaying resolutions. Assuming that additional funds are not available until late February or early March, the RTC will have fallen approximately one quarter behind in the resolution process. We estimate the present value cost of this delay at $250 million to $300 million. These estimates exclude three nonquantifiable factors: asset deterioration or other losses that might occur in understaffed or undermanaged institutions awaiting resolution, deterioration of franchise value, and the effect that competing with insolvent institutions has on the cost of funds of marginally solvent institutions possibly causing additional failures.

If additional funding for the RTC is delayed beyond the very beginning of March, the cost of delay begins to go up exponentially. Thus, we estimate that an additional quarters delay would cost an additional $750 million to $850 million in present value terms, or an average $250 million to almost $300 million per month. (In actuality, since the cost of delay grows exponentially, the cost of delay at the beginning of the second quarter is somewhat less than $250 million per month while the cost of delay at the end of the second quarter is somewhat greater than $300 million.)

The reason that the estimated cost of a second quarter's delay is roughly triple that of a single quarter's delay is that the longer the delay, the longer it takes to make-up for the time lost to delay. It takes twice as long to make-up for a two quarter delay as a one quarter delay. For example, if the number of resolutions were increased by 50 percent to make-up for lost time, it would take 6 months to make-up for a one quarter delay and a year to make-up for a two quarter delay. Moreover, it is not realistic to assume a 50 percent increased resolution rate can be sustained much longer than 6 months. If there was a two quarter delay, a 25 percent increase in the quarterly pace of resolutions is probably the most that is feasible beyond the initial 6 months push. Thus, it could take a year and a half to completely make-up for a two quarter delay.

As previously noted, our estimates do not take into account three factors: asset deterioration or other losses that might occur in understaffed or undermanaged institutions awaiting resolution, deterioration of franchise value, and the effect that competing with insolvent institutions has on the cost of funds of marginally solvent institutions possibly causing additional failures. However, it would not be unreasonable to assume that these factors might increase the cost of an additional quarter delay by at least 10 percent.

APPENDIX III

Requirements Established in FIRREA for Semi-Annual Appearances	Comments
I Report on the progress made during the 6-month period covered by the semi-annual report in resolving cases involving institutions insured by the FSLIC prior to FIRREA, and for which conservator or receiver has been appointed (from 1/89 to the 3 year period beginning 8/89). These institutions are referenced below as those described in subsection (b) (3) (A).	Detailed discussion is included in the testimony section entitled "Case Resolutions". During the six month period, the RTC resolved 235 institutions, exceeding its goal of 218 institutions. During the same period, conservatorship and receivership assets were reduced by $66.8 billion in book value.
II Provide an estimate of the short-term and long term cost to the United States Government of obligations issued or incurred during such period.	We interpret this requirement to address RTC short-term borrowings from the Federal Financing Bank ("FFB") and long-term borrowings from Resolution Funding Corporation ("REFCORP"). During the reporting period, the RTC had issued and outstanding about $53.0 billion in obligations in the form of short-term working capital borrowings from the FFB. Approximately, $900 million in interest expenses were incurred in connection with the issuance of these obligations during such period. These borrowings are fully collateralized by assets having an estimated fair market value substantially in excess of the borrowed amount. Accordingly, we expect that the U.S. government ultimately will not incur any cost in connection with these short-term obligations. REFCORP issued $8.5 billion of obligations during the reporting period, with $3.5 billion having a term of forty years, and the balance having a term of thirty years. The yield on each issue was 8.88%. Total interest expense is expected to be a nominal $25.8 billion. Annual fixed interest expenses of $755 million will be incurred in connection with these obligations. Under FIRREA, interest on all REFCORP obligations is funded jointly by the Federal Home Loan Banks (FHLBs) and the Treasury, with the FHLB contribution limited to a maximum of $300 million per year. As of January 1991, REFCORP had outstanding the full $30 billion of obligations authorized by FIRREA, with average maturities of 33 years and average yields of 8.76%. Total interest on REFCORP obligations is expected to be a nominal $87.9 billion. The Treasury share of this interest is expected to be a nominal $78 billion.

APPENDIX II

Methodology for Estimating RTC Losses

In order to make our estimates for our previous testimony, we developed a cash flow model for the RTC that gives us the ability to vary a number of assumptions for their effect on the RTC's ultimate costs. As we have discussed before, our low estimate assumed a population of about 700 institutions, which included those already resolved, those in conservatorship, and all institutions classified as Group IV thrifts by the OTS. Our high estimate assumed a population of just over 1000 thrifts, which included the 700 institutions in the low estimate, plus all institutions classified as Group III thrifts by the OTS.

It should be noted that our cash flow model does not deal with individual institutions. Rather total assets for individual thrifts are divided into 14 different asset types and then aggregated into tranches representing conservatorships, Group IV and Group III thrifts. The RTC's pace of resolution is selected not by choosing individual thrifts each quarter, but by choosing a volume of total assets in thrifts that are to be resolved each quarter.

The losses to be experienced by the RTC are estimated by applying a loss estimate, or "haircut" to each of the 14 different asset types, and adding that to the negative tangible net worth and accumulated operating losses prior to receivership of the resolved institutions. In making estimates, we used three different sets of haircuts. The medium haircuts were based upon the RTC's Division of Research bank failure cost model, while the other two sets were assumed to be higher and lower. The average aggregate haircut for these three scenarios ranged from about 14 to 25 percent.

Our cash flow model allows us to choose what percentage of resolved institutions are resolved in whole bank, clean bank and liquidation transactions, and to define each of these transaction types in terms of what percentage of each asset type gets passed to an acquirer. Our model also allows us to vary the pace of sale of receivership assets by estimating what percentage of each of the 14 asset types is sold each quarter until all are sold.

The estimates in our previous testimony were based upon year-end 1989 data, with the OTS Group III and Group IV classifications as of the end of April 1990. As OTS has released new data and thrift classifications, we have incorporated this information into the cash flow model. Our latest estimates, upon which the President's budget numbers are based, use data as of June 1990. OTS has only recently released September 1990 data and new Group IV and Group III classifications; based upon our preliminary analysis, it appears that this new data will not substantially change our current estimates.

Requirements Established in FIRREA for Semi-Annual Assessments	Comments
III Report on the progress made during such period in selling assets of institutions described in subsection (b) (3) (A) and the impact such sales are having on the local markets in which such assets are located.	Detailed discussion is included in the testimony section entitled "Asset Dispositions". It is too early in the process to assess the impact of RTC real estate sales on the local markets. To date, there is no evidence that RTC sales have had an adverse impact on local real estate markets. The RTC's National Advisory Board reports that the sale of RTC assets has not adversely affected local real estate markets to date and this observation is consistent with independent reports. The RTC will, however, monitor the impact of its sales activities in local markets through the input of its Regional Advisory Boards. The Regional Advisory Boards will receive analytical support from economists at the Federal Reserve to track and assess the impact of RTC sales on local market conditions. In particular, the new nationwide auction program will be carefully monitored.
IV Describe the costs incurred by the Corporation in issuing obligations, managing and selling assets acquired by the Corporation.	We have interpreted this requirement to address the assets of conservatorships and conservatorships which are under the management of the RTC. Costs in the range of $250-$300 thousand were incurred during the period in connection with the issuance of obligations by the Corporation. The total amount paid to private contractors during the April - September period was $99 million, of which $18 million represents fees paid under receivership asset management contracts. After the appointment of RTC as conservator, consolidate employees continue to perform asset management functions under the supervision of the RTC Managing Agent. These staff are already supplemented by outside contractors hired and paid for by the institution for services for which the institution would typically contract in normal course of business. Accordingly, we have excluded such costs for the purposes of this calculation.

Requirements Established in FIRREA for Semi-Annual Assessments	Comments
V Provide an estimate of income of the Corporation from assets acquired by the Corporation.	In its corporate capacity, the RTC's only "income" is interest on advances made by the Corporation to conservatorships and receiverships. The RTC accrued $300 million of interest income on advances and loans to conservatorships and receiverships in the six months ended September 30, 1990. Dividends are not included in income because they are a reduction in RTC's claims against the assets of the conservatorships, a source of capital, and not income. However, dividends received by the RTC during the period totalled $1 billion.
VI Provide an assessment of any potential source of additional funds for the Corporation.	The only remaining sources of additional funds to the Corporation are the normal borrowings for working capital from the FFB and the $5 billion line of credit from the Treasury provided in FIRREA. There are no other funds currently available to the RTC.
VII Provide an estimate of the remaining exposure of the United States Government in connection with institutions described in subsection (b) (3) (A) which, in the Oversight Board's estimation, will require assistance or liquidation after the end of such period.	The estimate of the total resolution cost to be borne by the RTC in connection with those institutions described in subsection (b) (3) (A) is projected to be in the range of $90 to $130 billion (present value). The RTC has expended approximately $57 billion for estimated losses from inception through December 31, 1990.

POLICY STATEMENT NO. 18

Oversight Board Policy Concerning RTC
Restructuring of FSLIC Assistance Agreements
["1988 Deals"]

1. Purpose and Statutory Background

This policy statement establishes guidelines for the RTC with respect to the restructuring of the FSLIC agreements ("1988 Deals") referred to in Section 21A(b)(11)(B) of the Federal Home Loan Bank Act, as amended by Section 501 of FIRREA. Pursuant to the requirements of that law, and in accordance with the guidance provided by this policy statement, RTC "shall exercise any and all legal rights to modify, renegotiate, or restructure such agreements where savings would be realized by such actions." FIRREA also instructs RTC to operate in a manner that "makes efficient use of funds obtained from the Funding Corporation or from the Treasury."

2. Restructuring Policies

With respect to the 1988 Deals:

(A) RTC shall make efficient use of Treasury funds appropriated from time to time for the purpose of lowering the government's overall cost of the 1988 Deals.

(i) RTC shall expend appropriated funds in a manner designed to maximize government cost savings with respect to the 1988 Deals as a whole. RTC need not expend any particular amount of appropriated funds in any specific transaction.

(ii) RTC need not expend all appropriated funds but should be willing to do so as necessary to achieve cost savings.

(iii) RTC may expend appropriated funds to prepay notes, purchase assets, mark down assets, or otherwise exercise the government's rights and options under the existing terms of 1988 Deals. RTC may renegotiate terms of a transaction instead of, or in combination with, such use of appropriated funds.

(iv) Except for the expenditure of appropriated funds to make scheduled payments under the existing terms of the 1988 Deals, the Oversight Board considers all expenditures of appropriated funds to constitute "restructuring" of the 1988 Deals.

(v) In determining how and when to expend appropriated funds, RTC shall take into consideration all relevant factors including, but not limited to:

(a) savings and projected savings that may be achieved through prepayments and exercise of other government rights under the 1988 Deals;

(b) savings and projected savings that may be achieved through renegotiation of the terms of 1988 Deals;

(c) projected increases or decreases in government tax revenues; and

(d) projected costs of thrift failures resulting from exercise of government rights under 1988 Deals.

Projected savings and projected costs shall be considered with due regard for the probability with which they can be expected.

(B) Where RTC seeks to renegotiate the terms of 1988 Deals, it shall seek to improve incentives for effective management and disposition of assets in a manner consistent with the concepts employed by RTC in its Standard Asset Management and Disposition Agreements.

(C) RTC shall employ uniform criteria for its decisions and actions concerning the so-called "stabilized" deals and the other 1988 Deals. With respect to any of the "stabilized" or other 1988 Deals, RTC may renegotiate terms so as to continue yield maintenance, asset loss coverage, and other forms of continuing assistance, where doing so is consistent with the goal of reducing the government's overall cost of the 1988 Deals, notwithstanding the Oversight Board's general policy against the use of such ongoing assistance with respect to RTC thrift resolutions apart from the 1988 Deals.

(D) RTC may seek to avoid government undertakings where fraud or other misconduct by persons contracting with the government provides a legal basis to do so. Where fraud or other criminal conduct appears, RTC shall refer the matter for prosecution.

3. Execution

In restructuring 1988 Deals:

(A) RTC may employ whatever resources it deems reasonable and appropriate, including FDIC personnel and outside contractors. RTC, however, remains responsible for the overall plan of the effort, for the methods used and results achieved, and for reporting to Congress, the Oversight Board, and the public.

(B) RTC shall thoroughly and completely document its procedures, decisions, and actions (and shall require the same by its agents and contractors) in a manner as to facilitate detailed auditing and investigation by RTC's Inspector General.

4. Performance and Monitoring

RTC shall report monthly to the Oversight Board regarding actions taken, amounts expended or to be expended, and cost savings achieved or projected as a result thereof. Reports shall be made with respect to the 1988 Deals individually and in the aggregate and shall include such detail, data, and explanations as the Chairman or the President of the Oversight Board may from time to time request.

5. Immediately Effective

This policy statement supersedes the Oversight Board's request for recommendations from the RTC as set out in the resolution adopted by the Oversight Board on September 20, 1990. Accordingly, this policy statement is immediately effective and RTC may begin immediately to restructure the 1988 Deals as provided herein.

SAA

EMBARGOED UNTIL GIVEN
EXPECTED AT 10:00 A.M.
JANUARY 23, 1991

STATEMENT OF HONORABLE NICHOLAS F. BRADY
Chairman, Oversight Board of the
Resolution Trust Corporation
before the
Senate Committee on Banking, Housing and Urban Affairs
January 23, 1991, 10:00 a.m.
538 Dirksen Senate Office Building

SUMMARY

The Oversight Board's most important objective is to impress on the Committee the urgent need for additional loss funds so the Resolution Trust Corporation (RTC) can continue to resolve failed thrift institutions. If the RTC fulfills its resolution goals through February, and if Congress does not provide such funds, RTC will have to cease its activity by the end of February, 1991, resulting in additional costs to the taxpayer of $750 million for delay of just one quarter.

RTC's preliminary operating plan calls for $30 billion in additional RTC loss funds to permit it to function through the end of fiscal year 1991. The Board urges Congress to provide the permanent funding necessary to get the whole job done. This would allow RTC to close failed thrifts as aggressively as it can and to avoid repeated, costly delays each time Congressional funding expires. Such a delay has already cost taxpayers up to $300 million. Funding this effort is not discretionary - Congress must supply the funds to fulfill government's obligations to depositors.

If Congress imposes on itself the burden of repeated votes on funding, the result will be a start and stop cleanup process that produces further delays, substantial additional costs to the taxpayers, and confusion and fear in the minds of depositors.

The Board estimated in June, 1990, that the final cost of the S&L cleanup would be in the estimated range of $90 to $130 billion in 1989 present value terms. Since that time many factors have affected the climate for RTC's operations including the condition of the economy, real estate markets, and the Gulf crisis. The estimated range is still valid, however, the cost has moved up within the range.

The Board believes RTC has made substantial progress. Since its inception in August, 1989, through December, 1990, RTC seized 532 thrifts and resolved 353, leaving it in control of 179 conservatorships on January 1, 1991. Another 179 thrifts in OTS's Group IV are likely candidates for new conservatorships. And 356 thrifts in OTS's Group III face an uncertain future.

Since its inception through December 31, 1990, RTC has reduced seized assets by $127 billion in book value, but remained in control of $146 billion of assets, of which more than 25% are securitizable.

The Board and the RTC are concerned that more assets, especially financial assets, have not been sold. The Board has adopted policies to speed such disposition, notably its policy on securitization. However, the RTC Board has been advised that potential personal liability problems have arisen which, if RTC asset disposition is to continue, may require early legislation to correct.

Progress has been made in using the private sector to speed real estate sales, through the Standard Asset Management Disposition Agreement (SAMDA) program. This program gives private contractors incentives to sell properties rather than hold them, at taxpayer expense, in anticipation of stronger markets.

In its concern that assets be disposed of more rapidly, the Board, at the RTC's request, recently adopted a new seller financing policy applying only to assets that cannot be sold because of inadequate private sector financing. Under the policy, a typical buyer would pay 15% as a down payment and the balance in installments. The taxpayer comes out ahead because either the asset is bought and paid for, or in the worst case, if the buyer defaults, the taxpayers have the downpayment, installments, freedom from carrying costs, and the repossessed property.

Since its appearance before the Committee last June the Oversight Board has adopted final rules on affordable housing. Through the end of 1990, the RTC affordable housing program has accepted $108 million of contracts on 2,737 properties with an average price of $38,442 for single family homes. The program provides a minimum of $250 million for affordable housing and is available to buyers at or below 80% of local median income, and permits listed properties to be sold at 80% of market value.

Progress is also being made in engaging minority and women-owned firms in the provision of services. Thousands of such firms are registered with the RTC, and hundreds have received contract awards.

The Board recently adopted a policy to spur RTC's immediate use of already appropriated funds to save taxpayer dollars by renegotiating 1988 FSLIC Deals.

The Board notes that enhanced law enforcement powers passed by Congress last year have helped contribute to more than 400 convictions of S&L executives and restitutions of $231.8 million.

Concluding, the Board again stressed the overriding importance of speedy passage of permanent funding to permit the RTC to complete the S&L cleanup as quickly and cheaply as possible.

The CHAIRMAN. We've been joined by Senator Heinz and Senator Sarbanes and I'm going to call on them for just a brief comment that they wish to make before we go to questions.

Senator Heinz.

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. Mr. Chairman, I apologize to our witnesses for being late, but, as you know, we had a mark-up in the Finance Committee.

I just want to say that I don't know of a more difficult task. While the RTC, over which you have oversight, is cleaning up the thrift industry, all of us, and especially myself, are concerned that it's the American taxpayer who may in the end be taken to the cleaners. It appears that the enormity of the RTC task is only exceeded by the enormity of its cost.

The Oversight Board has requested, Secretary Brady just testified, an additional $40 billion to $57 billion just for this fiscal year. And so what Congress thought was a $50 billion hole is rapidly becoming a black hole.

. Hopefully, by now, we have a clear image of the extent of the problems that we have to confront. It's obviously not a pretty picture.

The number of failed thrifts in the RTC has grown from 262 to 516 and, of course, hundreds more are on the way.

Unwanted assets are piling up at a phenomenal rate. Soft real estate markets are creating a hard reality of skyrocketing losses and costs to the taxpayer. There's a real risk that a Government firesale can cause the whole economy to go up in smoke.

At the same time, if we don't clean up the RTC inventory quickly and prudently, the taxpayers could end up getting burned.

Mr. Chairman, I look forward to having the opportunity to question the Oversight Board and, in particular, I will want to explore the extent to which they are satisfied with the current pace of thrift resolutions and asset sales. I must tell you, I am concerned that congressional patience—and my own patience, quite honestly—will wear as thin as the taxpayers' wallets.

Thank you.

The CHAIRMAN. Senator Sarbanes.

OPENING STATEMENT OF SENATOR SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman.

First, I want to commend you for moving promptly to schedule this hearing. It's really as early as possible in the new Congress. This committee has a significant responsibility in exercising oversight of the RTC and its Board, and I think we've been trying to carry that out with all due diligence.

Mr. Secretary, and your colleagues, I'm obviously going to reserve my questions to the question period, but I might as well telegraph them ahead of time and you can be thinking about them.

I am increasingly concerned by the constantly revised upward estimates of the cost of this matter. And I don't think we're spending enough time getting analysis and explanation of why the cost continues to go up.

Now, Secretary Brady, you have a paragraph or two in your rather lengthy statement on that on page 3 where you just mention a lot of factors as leading to these constantly escalating estimates of the cost of this operation and you're now seeking from us an open-ended authorization to incur any costs whatever that may be involved without having to come back to the Congress for a further authorization, as I understand your submission.

I must say to you, I find that a very troubling request, that we, in effect, should just sign off on a blank check. And it seems to me that, at a minimum, we need to address here this morning, and perhaps in some follow-ups, a more detailed analysis from the Board as to what has caused this constant ratcheting up of this operation.

We've gone from, I guess, $40 billion way back. Now we're at $130 billion. Your figure today is within the range you gave in your last testimony, but that was a range of over $40 billion at the time, from the low to the high. And I guess, as I recall that submission, I'd have to go back and check it, I think we were sort of left with the impression that the figure would be sort of at or close to the low range. And as I understand your testimony here this morning, we're at the high range, right at the limits, the high limits of that range.

So that's a $40 billion shift, if my recollection of the previous presentation is correct in terms of moving from the low figure of the range to the high figure of the range, is a jump of $40 billion.

Well, $40 billion isn't peanuts, obviously, and we're now at $130 billion.

In my question period, I just forewarn you. I'm going to be pressing to find out what it is, as specifically as you can pinpoint it, that has led to this very large escalation of the costs, and of course, trying to look to the future, what can we anticipate?

Thank you, Mr. Chairman.

The CHAIRMAN. Secretary Brady, as I understand your request today, you would like an open-ended authority. But for now you foresee needing $30 billion through the remainder of this fiscal year.

Is that correct?

Secretary BRADY. That's correct, Mr. Chairman. The request is in two parts. I want to make clear that we will obviously work with any decision that the Congress comes forward with. The request that Senator Sarbanes was just talking about for a permanent funding of the process is based on the fact that we're not going anywhere. We come up here rather frequently.

The Congress is always in the position of shutting off funds if they feel like it.

I can understand the line of questioning that we're opening ourselves up to when we talk about permanent funding. But in my heart of hearts, the one thing that disgusts me the most is to see people sitting on cots outside savings and loans and depository institutions wondering whether they're getting their money back.

So since, we know as a Government, we've all decided to fund these guarantees that we've made to the public, my thought is, why put the public through that anguish? We'll be up here any time you want us to testify.

On the other hand, if you decide that it's $30 billion you want to give the RTC, we'll obviously work with that.

It's my advice. You'll have to decide it's better handled by a permanent funding. We know we're going to do it. There isn't any doubt, I don't think in anybody's mind in this room that we're going to live up to those guarantees.

So I think the best way to do it, would be to do it permanently. I understand that there are other opinions.

The CHAIRMAN. So the record is clear, and I appreciate the point you've just made, the amount that you estimate you need to resolve cases in the proper fashion through the end of the fiscal year is the $30 billion.

Is that right?

Secretary BRADY. That's correct.

The CHAIRMAN. Now how about working capital? Is there a separate estimate for that? And if so, what is that?

Secretary BRADY. I will stand corrected by Peter Monroe, the president of the Oversight Board, but I believe that because of the action we took with regard to the note cap last fall we have sufficient working capital funds to get us through the end of the year.

The CHAIRMAN. And can you give us an estimate as to how much working capital you have now, then, having exercised that authority, Mr. Secretary, or Peter, either one?

Secretary BRADY. I think the figure we're going to use between now and the end of the year is $47 billion. That added to the previous amount that we had borrowed, $53 billion. It brings the total of working capital to $100 billion. $53 billion previously, $47 billion that we estimate will be used between now and the end of the fiscal year.

The CHAIRMAN. Now are you also implying that the working capital will all be paid back?

In other words, that's simply a revolving fund and if your projections are right, you have transactional activity, but when you net it all out, that money comes back.

Is that correct?

Secretary BRADY. Well, it does come back. It depends of course on the speed with which assets have sold, which I know is a question that other members will have.

The CHAIRMAN. But based on your projections, you expect to get the working capital back, that that's a revolving fund.

Secretary BRADY. Oh, yes, eventually, sure.

The CHAIRMAN. All right. Very good. I just want to pin that down.

Now, if the Congress did not provide the $30 billion for this fiscal year, what is your estimate of the cost to taxpayers?

Secretary BRADY. I believe, again, subject to getting the right figure from Peter Monroe, the figure would be $750 to $850 million for the second quarter of delay.

The CHAIRMAN. Per quarter. And what does that constitute? That's just premium costs that are incurred because you can't shut institutions down promptly?

Is that the principal——

Secretary BRADY. For that, I'll ask Peter to give you the details.

Mr. MONROE. It really is comprised of two parts. No. 1, the fact that the Treasury borrowings are cheaper and would replace the liabilities that exist. And No. 2, just the operating cost of those institutions which are primarily the cost of collecting liabilities and, to a lesser extent, the cost of managing assets.

The CHAIRMAN. All right. Well, you've given us your estimates on a quarterly basis.

I'm going to move along in 5-minute segments here because we've got a lot of Members who want to participate and others that have come since we've started here.

I want to put another issue on the table here, Chairman Greenspan, and I'll do it now because I want it out there and other Members may want to touch on it as their question periods come up.

We've obviously got the problems that have been accumulating in the banking system, separate and apart from the savings and loan situation. And we've had some major bank failures and we see continued pressure on bank balance sheets and also just the way the capital markets are valuing bank stock in terms of low price earnings ratios and so forth.

And there is a feeling held by many that we may have an interactive problem here where the banking situation and the constriction of credit, more severe in some regions than others, may be working across into the economy and helping to drive the economy more into a recession situation, and that that in turn then plays back the other way on the banks and on their capital positions.

And so you may have a situation where these forces are playing back and forth and driving the economy down faster than it otherwise would go.

I'm concerned about that. Members such as Senator Kerry and Senator Dodd, that represent areas of the country that are in extreme difficulty right now—feel that that may be happening. We've had testimony on that.

Some say, well, if that's the case, maybe the Fed can take some additional step to pull out of that kind of a nosedive, and there are others who argue that maybe the Fed can't do that even if it wants to.

But I want to know whether you think that kind of a cross-related dynamic is going on right now, and if so, what can be done about it?

Mr. GREENSPAN. I would agree essentially with what your position is, Mr. Chairman.

As I indicated to the House Budget Committee yesterday, it's clear that even though there is some evidence that the degree of intensity of the credit crunch may be topping out, it is sufficiently severe to create considerable concerns at the Federal Reserve.

There are various different ways of measuring it. But what is clearly the crucial problem is that commercial bankers, for a number of reasons, concerned about the status of their capital asset ratios, have been pulling back.

They originally tried to obtain additional capital in the markets and, in part, because of stock market conditions and others, they've had difficulty in that respect.

So, obviously, if you have a capital-asset ratio which you're trying to keep up and you have trouble with the numerator, you work on the denominator. And the data clearly are showing that.

We have disaggregated the lending by commercial banks in a number of ways. But one of the most interesting ways is the break that we show between those banks which are relatively well capitalized and those which are not.

What one very readily sees is the rate of growth in the well capitalized banks holding up, while growth in the less well capitalized is clearly deteriorating.

And we are seeing, obviously, a change in the market share of lending towards the well capitalized banks.

Eventually, that process will engender a degree of competition creating a concern on the part of those who are pulling back on lending about the nature of their franchises because, obviously, if they are not lending to the creditworthy customers that they have, they will eventually find that they may have kept their capital asset ratio from deteriorating, but in the process, they may well have lost a significant amount of their customers and the value of the franchise itself.

The CHAIRMAN. And might some of the customers' businesses not also fail at the same time?

ALAN GREENSPAN, MEMBER, OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, WASHINGTON, DC

Mr. GREENSPAN. They may indeed. And, in fact, one of the things that concerns us is that while we know if we wait long enough, it will eventually work, we are concerned, as you are, that time is not on our side, so to speak, in this area.

The specific form in which it is showing up, obviously, if the asset expansion of the commercial banks is slowing down, you would expect to find it also in the money supply.

And indeed, we do. We are particularly focused on M-2, which picks up not only the commercial banks, but the thrifts and a number of other elements in the system which are directly reflective of this process.

We have found that in recent months, the money supply has drifted significantly below the path that it would have historically been maintained on, given the path of interest rates, which have been coming down now since the spring of 1989.

It's our view that unless that path is re-established, we will be observing the type of constriction which is of concern to you, and while we think there is a reasonably good possibility that the fairly marked decline of late in the Federal funds rate and other borrowing costs of the banks have opened up profit margins enough in the commercial banks to engender some significant change in the state of the credit crunch, that may not turn out to be the case and we may have to take additional actions.

We, I might say, are also looking at——

The CHAIRMAN. May I say, what might those be? What's left in the additional actions?

Mr. GREENSPAN. Obviously, if the money supply does not come back on track, one way is to bring Federal funds rates down lower. But we are looking at other issues as well to find means by which we can restore a modicum of rational lending here where we're dealing with creditworthy customers.

There is no question that part of the slowdown reflects the fact that the demand for loans has clearly gone down. But there's very obviously much more to it than that.

And we're looking——

The CHAIRMAN. Well, let me stop you there just for a minute.

So can I conclude from what you've just said, that in addition to lowering the Federal funds rate further, which is an option, you're looking at other strategies to try to take and strengthen this trend line to get it back up to where you think it should be running and not at an unusually depressed level?

Is that fair?

Mr. GREENSPAN. Well, I would say that rather than looking at means of getting the trend line up, we are looking at possible other strategies which would confront the credit crunch.

The CHAIRMAN. Can you talk about those at all today? Can you give us a range?

Mr. GREENSPAN. I would just as soon not. Until we come up with something that we feel comfortable with, I would just as soon not put on the table ideas which turn out to be impractical or unfeasible.

The CHAIRMAN. You were going to make a final comment and I didn't mean to prevent you from doing so.

Mr. GREENSPAN. No. What I was going to say, Mr. Chairman, is that we consider that sustaining the growth of credit and monetary aggregates to the moderate levels which we will discuss when we appear before this committee again in a few weeks, is essential to keeping a stable, growing, noninflationary economy.

The CHAIRMAN. Senator Mack.

Senator MACK. Thank you, Mr. Chairman.

I want to build on the comments that I made sometime ago, indicating that one of the things that we ought to be looking at in order to reduce the cost of this entire bailout is a question related to what kind of policies should we be following that would get our economy moving again, that would have a positive impact on the value of assets.

And so I'm going to pose this question to the entire panel. Chairman Greenspan, I'd like for you, if you would, to respond first.

What impact do you think there would be if we were to lower the capital gains rate? What impact would it have on the value of assets, the value of real estate? And what do you believe would happen as a result, as its impact on the total cost of this bail-out?

Mr. GREENSPAN. Well, I've always, as you know, been supportive of either lowering the capital gains tax or, preferably, eliminating it completely because I don't think it is the type of tax which will promote growth in the economy.

It's fairly evident that, to the extent that the capital gains tax is lowered, you will get potentially higher property values because, if you have a speculative purchase of a property, to the extent that

that anticipation of capital gain is hit by a significant capital gains tax, you will clearly get some restraint, resistance, or hesitation.

So leaving aside all other policy considerations, and there are obviously other ones, there's no question in my mind that the capital gains tax cut would be helpful with respect to the issue of property values and economic growth.

There are, as I indicated, all sorts of different calculations with respect to the impact on the bail-out costs.

These calculations are extremely difficult to do in any reasonably sensible way. And at the moment, I would not have a realistic judgment for you as to what I think would happen under those circumstances.

Senator MACK. OK.

Secretary BRADY. Senator Mack, and then we can go to the other Members of the committee, first of all, as you know, this is a matter that the President has under consideration.

So my remarks will be somewhat general until he makes his mind up, which he will do in the next several days.

As a theoretical matter, I've always been in favor of lowering the capital gains tax and remain so. But to the extent that the estimators at Treasury and the estimators that are in the JCT and the CBO, are unable to come to any agreement as to what effect that has on the economy, and to the extent that that disagreement promotes a search for other taxes to make up for the obvious benefits of the capital gains reduction, it is my opinion that there is considerable virtue in settling that discussion before we go forward into what obviously has been a boon to various other economies—Germany, France, Japan. Anywhere you go, there's a lower capital gains tax rate.

But until the situation clears up whereby the Office of Tax Analysis estimates and the congressional estimates produced wide-ranging differences, which start arguments which divide this country over who should be taxed, I think there's considerable virtue in settling that argument before we settle whether we should proceed on a capital gains tax proposal.

But as for the basic virtue of capital gains, I've always believed it. I still believe it. I haven't heard anything in the last 2 years in this job that make me doubt it.

What I have heard in the last 2 years in this job is we have a very inadequate system for assessing what the virtues of that are, what the actual numbers affecting capital gains are.

So I think we ought to clear that up first.

Senator MACK. Let me just ask you a follow-up to that. And you don't have to speak for the administration, but let me get you to react to—do you have any question in your mind that lowering tax rates increases the value of assets?

If you have to pay fewer taxes, doesn't that somehow affect the value of an asset?

Secretary BRADY. Of course. But I don't think that that's the question that's before us when we talk about capital gains.

If you could assure me, Senator Mack, that you could put that proposition through Congress, I would be the first man in line.

What you can't assure me of is that in putting that kind of a proposition through Congress, that you don't raise other taxes. And

I think that that particular argument is one that we had last year. It's over with and done with. We spent a lot of time on it.

That's my position. You'll hear from the President shortly.

Senator MACK. So that what you're saying is that the factual data that I express is something that you agree with. Is there anybody that disagrees with the position that lowering tax rates will increase the value of an asset? And if we do that, that we're going to actually reduce the cost of the bail-out to the taxpayer.

Is there anybody that disagrees with that?

[No response.]

Senator MACK. Then why in the world, with all of the discussion that we've had here this morning, can we stay in a position that says that we're not going to deal with this, we're not going to lower that tax, in order to increase the values and reduce the cost to the taxpayer?

Secretary BRADY. Well, I don't know as we should, Senator. But I think that the statement, the question that you posed isn't a complete question. And I want to make sure that you understand that I'm for capital gains.

Senator MACK. No, I understand.

Secretary BRADY. As long as you can say that you can put a capital gains tax through Congress that doesn't at the same time raise other taxes, then your question ought to be answered in the affirmative.

I don't think you're in the position to do that, Senator, with all due respect. I wish you were.

Senator MACK. I do, too, and I appreciate your comment.

But what you're really saying is that the argument that we're making will in fact increase the value of assets and reduce the cost to the taxpayer.

Now we'll have to let the political debate take place and people can decide whether they want to reduce the cost of the S&L bail-out to the taxpayer or not.

All I'm trying to do is to make the point that lower capital gains taxes will in fact save the taxpayer money and will in fact increase the value of assets. And it will do one other thing—it will get the economy moving again.

And if you want to reduce the cost to the taxpayer of this program that we're talking about, get the economy moving again.

Thank you, Mr. Chairman.

The CHAIRMAN. Let me just say before going to our next Senator for questions, I want to welcome Senator Domenici to our committee as a new member of our committee.

I want to just say, we have a practice on the committee that when Members arrive, even though we're in the midst of the question period, that we try and accord each Senator an opportunity for an initial comment.

We've had three more Senators join us. We've had almost perfect attendance today and everybody's juggling multiple committee assignments.

But let me just call on Senator Dodd for any initial comment he wants to make, and then I'm going to do the same with Senator Pressler, and then you, Senator Domenici, and then we'll go to Senator Wirth for his questions.

Senator DODD. Well, thank you very much, Mr. Chairman. And let me join in welcoming our distinguished panel of witnesses this morning.

I would ask unanimous consent that my prepared statement be included in the record.

The CHAIRMAN. Without objection, so ordered.

OPENING STATEMENT OF SENATOR CHRISTOPHER J. DODD

Mr. Chairman, I would like to join my colleagues in welcoming Secretary Brady, Secretary Kemp, Chairman Greenspan, and Mr. Larson and Mr. Jackson to today's hearing. This is an extremely distinguished panel, but of course, the challenges the RTC continue to face are unprecedented and formidable in the extreme. I look forward to your testimony this morning.

Mr. Chairman, today's hearing on the Resolution Trust Corporation is unpleasant, but unnecessary. It is unpleasant because the Resolution Trust Corporation was created specifically to deal with the unprecedented task of cleaning up the Nation's legion of insolvent savings and loans. This clean-up so far has cost more than $100 billion, and today's hearing will lay the groundwork for the unejoyable job of raising additional moneys to allow the RTC to continue its work.

I believe that one reason why the recapitalization of the RTC is so unpleasant is that many Americans still have the impression that it is thrift managers, not thrift depositors, that are being bailed out. Of course, nothing could be further from the truth. The thrift managers who ran their institutions into the ground have been dismissed, and many have been or are being prosecuted. The people who are being rescued are the millions of Americans with deposits at thrifts, who would see those deposits vanish into the air if the Federal Government refused to carry through on its deposit insurance commitments.

Today's hearing is necessary for two reasons.

In the first place, we must be able to assure Americans that the consequences of this bailout of depositors—the sale of billions of dollars in assets from insolvent institutions—is proceeding in the most cost-efficient manner possible. To the extent that problems and deficiencies in RTC operations are revealed in this hearing, I hope that the RTC will be forthcoming with concrete recommendations for remedies, both administrative and legislative. In this regard, I look forward to working on RTC reforms, which I expect will be a component of the deposit insurance-banking modernization bill we will be considering later this year.

Mr. Chairman, I believe that the other reason this hearing is important is that we have no alternative but to provide the RTC with additional moneys. Under present projections, the RTC stands to exhaust all its available resources by the end of February resolving cases of thrifts already in receivership. With more than 530 other savings and loans either failed or in danger of failing, the RTC has a great deal more work to do before its job is done. If we delay recapitalizing the RTC, I am afraid we will only delay the inevitable and expensive clean up that must take place, and increase its final cost.

I gather, to some extent, Chairman Greenspan has responded to an inquiry that you made, Mr. Chairman, regarding the New England situation. I know Secretary Brady, we've had discussions with Secretary Glauber and members of the Connecticut New England banking community and business community.

We had an extensive meeting this morning which Senator Kerry and I were present at, along with, I think, virtually every member of the New England delegation.

And just to say to you, I realize that this gets a little bit afield, Mr. Chairman, of the specific purpose of the hearing here this morning, but certainly, you would understand why we would not want to miss the opportunity of at least raising once again this issue with you.

And that is we're not engaging in hyperbole or dramatics or pyrotechnics when we tell you we are hemorrhaging. Badly. Badly in New England. This is not going to be unique to us. It's going to spill over to the rest of the country.

We're satisfied at least that there seems to be some change of mind about some bridges that might make it possible for institutions that are capable of surviving, to do so without waiting until they're lost causes and then trying to find a buyer some place and all the problems associated with that.

So, Mr. Chairman, I intend to support the RTC's request for additional funds. I think it's absolutely essential. There's no other way you can deal with this problem. And I realize it may be popular to not support it and I realize the politics of it, but it is highly irresponsible, in my view, not to.

I know we'll look at reforms in this area when we look at the FDIC reforms and the like, in order to make sure that the RTC cleanup functions well.

But we need to get about the business of cleaning this mess up. My hope is that as we're doing that, we also focus on what is happening in my part of the country—and which will clearly happen in another—if we don't take some steps, whether it's net worth certificates or accounting procedures to try to make it possible for these institutions to once again lend to creditworthy borrowers.

So I realize that does get a little bit afield of the subject matter at hand here, but I appreciate the opportunity, Mr. Chairman, to raise that issue and would hope that our witnesses would feel comfortable about responding to it, in addition to the other questions which relate directly to the RTC issue.

So I thank you for that.

The CHAIRMAN. Thank you, Senator Dodd.

Senator Pressler.

Senator PRESSLER. Thank you, Mr. Chairman. I do not have a statement at this time, but I will have some questions for the witnesses at the appropriate time.

The CHAIRMAN. Very good. Senator Domenici, did you have a comment that you wanted to make?

OPENING STATEMENT OF SENATOR DOMENICI

Senator DOMENICI. Well, Mr. Chairman, first, as a new member, I chose this committee because I thought that I could contribute

something, and I understand that this committee is going to have a very difficult job. I am only hopeful that I can contribute.

I want to apologize for being late and thank you for your good policy of allowing Members to make remarks when they arrive. When I ran a committee, I wasn't as generous. Members who came late waited. OK perhaps when the meeting was over and everyone was gone, they were allowed to talk.

I think you have a much better policy. And when the Republicans are back in the majority and I am chairman, I will borrow it.

The CHAIRMAN. Very good. [Laughter.]

Senator DODD. Not in your lifetime. [Laughter.]

Senator DOMENICI. Since I don't have very much gray hair, it might occur while I still look all right.

First of all, I apologize for being late. As a new Member, I do look forward to these challenges. I'm not sure I can take them for more than 2 years, but I am willing to sign on for one Congress at a time.

This should to be a very busy year. None of the issues are easy ones, but, Mr. Chairman, I'm hopeful that together, even though they're difficult, that we can get on with them.

I don't think delaying some of them does any good for anyone, including Congress. I think some of us as politicians think that delaying the funding requests of the Resolution Trust Corporation is good for us politically. I think it is good for no one.

Americans are looking for some leadership and they're looking for things that will help the American economy move ahead and start growing again and prospering.

I conclude from my very first Banking Committee hearing that delaying the RTC loss funding is fiscally irresponsible. We ought to get on with doing what we have to do. The longer we delay this, the more we cost the taxpayers and the more we impose doubt and concern on the attitude of our people about the status of the institution called banking.

And if we have learned anything, we have learned that in a capitalist society, if the people don't have confidence in that very basic system called the banking system where money comes from, it has a negative impact on their attitudes and thus, on our potential for growth.

So with the protections that the RTC has been given in the budget act and in the new budget agreement, we don't have any fiscal reason for not proceeding.

In the Budget Agreement we have accommodated RTC funding and protected it as best we could because it is a very long-term investment. And so I join you with the hope that between us, we can make decisions on this issue and decisions in the ensuing 2 years on the entire banking system of America to make it better, to make it more effective, more operative, and more competitive.

Thank you very much.

The CHAIRMAN. Thank you. We're delighted to have you join us as a committee Member. Before I call on Senator Wirth I have a statement from Senator Sasser that will be invited in the record.

STATEMENT OF SENATOR JIM SASSER

Senator SASSER. Thank you Mr. Chairman. I want to talk briefly about the special concern I have about the course of the economy. We have an expenditure at issue today that is almost completely driven by the outlook for real estate markets. Indeed, this isn't just true for savings and loans, it's also, unfortunately a problem with banks. During the 1980's, commercial banks increased their real estate lending as a percentage of their assets from 16.4 percent to 25.2 percent. Banks are now bigger real estate lenders than they are commercial lenders.

Thus, the exposure of the taxpayers—which the Bush administration is telling us is massive—is dictated by the performance of real estate. And nothing affects the performance of real estate more than the price and supply of credit.

It goes without saying that the Federal Reserve has a special responsibility here. There is enormous fragility in our financial system; now is not the time for a single minded assault on inflation.

The Fed must do more to reduce interest rates and make more credit available. The Fed must address the dual problem of relatively high interest rates and the credit crunch.

I encourage the Federal Reserve to get the economy moving again, and to ensure that this banking situation doesn't drive the budget deficit through the roof and the economy through the floor. Thank you.

The CHAIRMAN. Senator Wirth.

Senator WIRTH. Thank you very much, Mr. Chairman, and I want to welcome as well Senator Domenici, with whom I am privileged to serve as well in the Budget Committee and the Energy Committee.

DELAYING FUNDING

Mr. Chairman, there's been a good deal of bashing of the Congress this morning for "delaying funding" of the RTC. The Secretary in his testimony said as a result of congressional inaction on funding, RTC was forced to revise its goal to resolve 97 thrifts.

In other words, he's suggesting that it couldn't move. And he also invoked pictures of people sitting in front of thrifts waiting to get deposit-insured money, obviously the Congress' fault as well by implication.

Let me just point out what the record is on the request for funding on the RTC. And at the time that we started this, Mr. Chairman, I think both you and I said what we saw happening was the administration not sending up a request so that they could blame the Congress.

You and Chairman Byrd and Chairman Sasser on July 16, 1990, sent a letter to Secretary Brady asking for what their request was for funding. He wrote back on July 31, 1990, but no request for funding.

At hearings on July 31, 1990, you made the same request. There was no response.

In a letter on September 13, 1990, you wrote to the Secretary requesting what the administration wanted to do. No response.

On September 20, 1990, we had a hearing with Chairman Seidman. A significant discussion of the need for this. No response from the administration.

On September 26, 1990, Mr. Glauber was up here on behalf of the Secretary. I asked him extensively what it was the administration wanted. There was no answer.

On October 9, 1990, you and Chairman Gonzalez wrote to the Secretary and asked for the administration's request. That finally arrived from the administration on October 10, 1990, 4 months after the initial request, in a letter from the Secretary to you, and the Secretary wrote to you on October 12, 1990, after you and Senator Garn had hearings on the subject and we authorized that in the Senate.

Four months, Mr. Chairman. Four months before we got a request from the administration.

Ultimately—there was 10 days left in the session to get this passed—it ultimately died in the House, I understand, because the House was very unhappy that the Secretary did not come up and testify and make the request personally.

Now I just find it a bit disingenuous, Mr. Chairman, to go around here talking about people sitting in front of thrifts and not acting because the Congress hasn't acted. That's just not what the record is.

And we predicted this is what these people were going to do and now they're doing it and I'm sorry that that's the case. We have a big job to do, without getting into the business of this kind of nonsensical finger-pointing.

Let me, if I might, Mr. Chairman, go to the issue of environmentally sensitive properties that was referred to briefly by the Secretary.

The legislation, FIRREA requires, as the Secretary pointed out, the RTC to "identify properties with natural, cultural, recreational, and scientific values or special significance."

RTC has identified almost 2000 properties worth a little more than $300 million. The purpose of this, this identification, is to allow bidders who have particular concerns about property of significance, like properties located adjacent to national parks or wetlands, to be purchased by private, nonprofit groups, or state and local governments, to kind of flag the importance of these properties.

Initially, the identification of these properties was done as part of the ordinary real estate appraisal and it became clear that that wasn't working because appraisers didn't have the expertise of identifying what particular values were going to be.

As a result, the RTC entered into negotiations with the Fish and Wildlife Service to have the service review properties in the RTC inventory. The negotiations led to a memorandum of understanding which was announced in November in the RTC packet that was distributed by the RTC board in which they announced in November that the RTC and the U.S. Fish and Wildlife Service have signed a memorandum of understanding with respect to properties with wetlands and critical habitat.

That was announced in November that that decision had been made.

We talked to Mr. Monroe about that in testimony up here in September and Mr. Monroe acknowledged that that was going on and he said that, in fact, because the drafting of this agreement is principally a means of defining operating procedures, the Oversight Board at this point has taken no action on it.

We assumed that this was going forward.

And suddenly, on January 17, 1991, the Oversight Board reversed all of this which had been agreed upon policy for almost 2 years, I think, the oversight policy, and directed the RTC I guess to overturn what had been an announced memorandum of understanding.

This morning, the Secretary told us that the RTC did not want to delegate responsibility for the identification of these properties.

Well, there's nothing in the memorandum of understanding that talks about any delegation of responsibility. There's nothing there at all. The RTC has the full right under the MOU to accept or reject any Fish and Wildlife recommendation. The RTC has the full control of all decisions.

Suddenly, for some reason, this policy of using the expertise of the Fish and Wildlife Service, particularly as it relates to lands that may be significant wetlands, presumably, the administration has a policy of no net loss of wetlands. Maybe they've abandoned that, but this would seem to be a good way of identifying this kind of property.

So the question is why did the Oversight Board become involved in this?

You told us, Mr. Monroe, this was just an operational deal. Why did they and when did the Oversight Board become involved in it?

Would you fill us in on that, Mr. Monroe, or maybe Secretary Brady?

Secretary BRADY. Senator Wirth, you raise two questions. One with regard to testimony. I think probably at this point in time it's better to look forward rather than backward.

Senator WIRTH. I couldn't agree more.

Secretary BRADY. My comments with regard to people waiting on cots were not in any way trying to indicate that it was the Congress' fault. I was answering a question by Senator Sarbanes on permanent funding. It had nothing to do at all with Congress' responsibility and the lack of funding this last year.

What it did refer to is raising the continuing spectre of whether we were going to have enough money or not. I don't think that, for reasons that I expressed before, that that adds to the discussion. But it had nothing to do with pointing the finger at Congress.

I just wonder whether it's smart to get into it on a semi-annual basis.

Senator WIRTH. I didn't raise it, Mr. Secretary. You did on page 4 of your testimony. Since we've heard a lot of it this morning, I just wanted to set the record straight.

I agree with you. Let's look ahead. That's what we ought to be doing.

ENVIRONMENTAL QUESTIONS

Secretary BRADY. With regard to the environmental questions that you have raised, first of all, I'm going to ask Peter to reply to your question. But I do want to indicate to you that there is an enormous concern at the RTC with environmental matters. We have a book which I would be glad to share with you and your staff which is unbelievably thick and comprehensive, which is entitled, "Environmental Guidelines and Procedures."

We do have an environmental concern in this particular case, in this particular responsibility where we are required to identify properties with natural, cultural, recreational, and scientific significance.

We want to retain the right to pick and choose among the very many qualified institutions for that purpose.

Senator WIRTH. There's nothing in the memorandum that limits the RTC's ability to pick and choose. All the memorandum does is to say, let's use the expertise of the Fish and Wildlife Service to help identify these properties.

Now suddenly, for some reason, there is an intervention to change that particular agreement.

Mr. Monroe.

Mr. MONROE. I think what we found is that the RTC has already implemented rather extensive procedures to identify properties of all four types. It was felt more efficient to build that capacity and also to make sure that when properties are identified, that we also note that the RTC notify interested parties, buyers and regulators, rather than entering into just the whole series of memorandum of understandings with specific agencies.

If the RTC were to enter into an agreement with the Fish and Wildlife, they could just as logically enter into agreements with 30 or 40 other Federal agencies that have interests in these types of properties, as well as up to 150 state and local agencies.

We just felt that that wasn't efficient. It wasn't a good use of time.

Senator WIRTH. What aspect is there in using the Fish and Wildlife Service to identify these that says you're going to open up the door to a lot of other things, Mr. Monroe?

You have this amendment. You put out in your own book on page 15 the fact that you've got this memorandum. You've identified that. It's been going on. There's been no problem there.

What was the problem that got caused on this? It was an operational issue, you said, in September. Suddenly, for some other kinds of reasons, it was raised to the Oversight Board.

What's the reason for that? The operational people seem to think it made perfect sense to do this.

Mr. MONROE. I believe it was a matter of just straight management efficiency and the fact that the RTC has developed good procedures.

Senator WIRTH. When did the Oversight Board decide to reject this memorandum of understanding?

Mr. MONROE. The decision was made January 16, I believe.

Senator WIRTH. Is there a transcript of that meeting?

Mr. MONROE. Yes, sir.

Senator WIRTH. Was that a public meeting?

Mr. MONROE. No, it was a closed meeting.

Senator WIRTH. It's not a public meeting. Could we get a transcript of the meeting?

I mean, I'd like you to go back and look at it again. It doesn't seem to me it makes any sense at all, unless what you're effectively saying—

Secretary BRADY. Senator, I don't think it was the January 16, 1991, meeting. It was earlier than that.

I think it was in December. But we can provide you with the date. It was the December meeting, I believe.

Senator WIRTH. Can we get a transcript? Was this open? Was there any discussion of this?

This is something that's been going on for a long time. And suddenly, for some other kinds of reasons, which I don't think have been expressed here, you've said, maybe we're going to open this up to a lot of other agencies, I don't see why having an agreement with the appropriate technical agency opens it up to 30 or 40 or State and local governments. That doesn't exist in this.

Anyway, I would appreciate it maybe Mr. Secretary, if you could go back and look at this.

It just seems to me that this is a step back from something that was working very well, having started very awkwardly with RTC trying to do it itself, found it couldn't do it, went to the Fish and Wildlife Service, worked out an agreement, and now for some other kinds of reasons, decided not to do that any more.

I'm sorry to see that and maybe you could review that again and we could talk about that.

Thank you, Mr. Monroe. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Senator Gramm?

Senator GRAMM. Mr. Chairman, let me begin by asking Mr. Monroe a question.

If someone buys your property, are they not subject to the same environmental restrictions as anybody else in using that property?

Mr. MONROE. Yes, sir.

Senator GRAMM. Well, Mr. Chairman, I'd like to be sure there's a counterweight going in the other direction.

Now we have set up a procedure where we're giving the homeless access to these properties. We set up a procedure where if a thrift fails, investors with the same ethnic background as the previous owners of the failed thrift have preference.

Now we're putting you into the environmental protection business. All of those are great and noble tasks. But the bottom line is that this is the taxpayers' money you're dealing with. And every time you give somebody preference, that means tilting the market place and ultimately costing the taxpayer money.

I'd like to put my little two cents' worth in that the taxpayers are paying for this operation. This is not a housing program. It is not an environmental program. It is not a social or ethnic levelling program.

It ought to be a business transaction to husband the taxpayers' money.

So while you're getting all this pressure to go in the other direction, I wanted to let you know that there are people here who care

about the people who do the work and pay the taxes and pull the wagon and who are almost totally forgotten in this whole process.

Mr. Chairman, let me also say that, in following up Senator Mack's statement, obviously we have a problem in the capital gains tax. Everybody that I've heard agrees that reduction of that tax is a good thing for the economy. But Congress sees a terrible problem in that America cannot be saved except by the profit motive.

Cutting the capital gains tax has only one weakness in the eyes of Congress, and that is that people who respond to it and who make money by that will benefit. And it is a terrible thing in the Nation's Capital when people who save America benefit from the process. As the orthodox hardliners could tell us, who made the old policies in the Kremlin and in Eastern Europe, that's terrible.

That is what impedes our progress here. I think anything that you can do in your official capacity at RTC to let the public understand the favorable impact on your very costly mission of lowering the capital gains tax would be very beneficial to this debate. I don't think there's any doubt about the fact that if we were to overcome that problem we would see action.

And since we're talking about saving the taxpayers money and creating more taxpayers by creating jobs, I think that it is very important that a capital gains tax happen.

I would commend that task to all of you.

CREDIT-INDUCED RECESSION

Chairman Greenspan, let me go back to a point I raised in my opening statement and convert it into a question.

Do you see this recession as a traditional inventory cycle or, in fact, is this, at least to some major extent, a credit-induced recession, and how different is that and should we be concerned about it in looking at its possible duration?

Mr. GREENSPAN. Well, first, Senator, it clearly is not an inventory-induced recession. We do not have an inventory build-up, or inventory excess, which has been the more classic form of business cycle, especially in the post-World War II period.

I would not, however, argue that this is a credit-induced recession, in the sense that the squeeze that is occurring in the financial intermediaries is itself adequate or strong enough to turn the economy down.

I do think, however, that one can clearly argue, as indeed I think most people here would, and correctly so, that the credit restraint has been an inhibiting factor and after the recession began, a contributing element in the extent of its depth and duration.

So it is an issue which clearly requires appraisal. It certainly is a phenomenon which has not existed in the recent past. I don't recall in the post-World War II period anything resembling the force of credit-induced contraction, credit quality, I should put it.

We've had obviously many contractions where credit tightened up as a result of a number of other things. But not as a consequence of actions taken by commercial bankers to essentially protect their capital positions.

Senator GRAMM. In my final seconds I want to give the Secretary of HUD an opportunity to outline anything that he believes we

need to do to try to promote a solution to this problem, to try to promote the orderly disposition of the RTC-held property.

JACK KEMP, MEMBER, OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION, SECRETARY, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, WASHINGTON, DC

Secretary KEMP. Well, it would be no secret, Senator Gramm, that I would agree with you insofar as you have made a very strong point along with others on this panel that this is not an inventory and cyclical business recession.

In my view, it is a man-made recession, without pointing the finger because I don't think that is necessarily useful.

It seems to me that both Congress, the administration, the regulators and the Fed all have a stake in making sure that we come out of this slow-down in the economy as quickly and as strongly as possible. And that means that interest rates, capital gains tax rates, the regulatory process, all have a big stake in making sure that not only do we come out of it soon, but that we come out of it stronger than with just the low rates of growth that I've seen estimated by everybody from the CBO to some of us downtown.

In my view, it was preventable, but that is hindsight. Having travelled throughout the Northeast, I agree with Senator Dodd that there is a hemorrhaging among financial institutions and real estate values in the Northeast.

It will spread if something isn't done. I believe with all my heart that the bone stuck in the body economic at this point, among other things, is the very high tax rate on financial assets particularly in this case, real estate values; assets that were in some cases purchased in the high inflation of the 1970's.

And never forget parenthetically that the capital gain tax cut is a voluntary tax. If you don't sell an asset, you don't pay it. And if you bought that asset in the late 1970's at the height of inflation and sold in 1989 or 1990 or now in 1991, the effective tax—that is, the tax on the real appreciation of the value of that asset—plus the nominal value of that asset, approaches in some cases on real estate a 75 percent effective capital gain tax.

There's no country in the world in my view that can survive such a high capital gains rate. I believe that Secretary Brady is correct in suggesting that all the econometric models have discounted not only the unlocking effect and the value that would have, but also the point that you made and Senator Mack made earlier, that the value of financial assets, i.e., real estate, homeownership, farms, stocks, bonds and equity values in America, would rise. Thus, the tax base would expand and given the savings to the taxpayer, the savings in the reduction of the cost to the S&L bail-out, the savings to the American cities and governors who are facing deficits from New York to California, it seems to me, it would be well worth the risk that some believe is attendant to cutting the capital gains rate.

A postscript. I agree with you. There are some people in this country who are more worried that somebody is going to make a profit and that someone might get rich than they are about what's

happening to the real estate market and the financial assets of America. I think that is the politics of envy.

It's ironic to me to read in the Wall Street Journal this morning that Germany has eliminated the capital gains tax in East Germany to try to get that economy going. Czechoslovakia is not even going to put a capital gains tax on because they know that they want to create wealth, not redistribute it.

It seems to me ironic that the country of democratic entrepreneurial capitalism can't come to some agreement over President Bush's, I think, modest approach to lower it to 15 percent and index it. And that, among other things, I think would make a very valuable contribution to saving the taxpayer money and lowering the cost of the S&L bail-out.

Senator GRAMM. Thank you.

The CHAIRMAN. Senator Kerry.

Senator KERRY. Mr. Chairman, this is obviously not the time or place to debate the capital gains tax.

I happen to be a supporter of a reduction in the capital gains tax, at least a targeted one, and I advocated a long time ago when Chairman Greenspan was here that we ought to be thinking of ways to revalue this devalued real estate.

I would like to see us—I probably have a bill in for the lowest capital gains tax targeted again of anybody in the Congress. So I'm not opposed to it.

So I think the question Senator Mack posed and the proposition that has thus far been laying on the table with respect to it is incomplete because it's a tax expenditure. And to whatever degree you are foregoing revenue, you are going to have to have some kind of evidence that the revaluation is sufficient to either make up for it or at least to create enough give-back to the economy that it's worthwhile as to that.

And there's no showing that low-risk investments on Wall Street and so forth that don't necessarily create new jobs is somehow going to make up for it.

So I think the inquiry has to go a little bit further. But I think it's worthwhile. I think it's an inquiry that ought to be made. And I think that whatever ways we can find—and the Enterprise Zone is another concept that I think might revalue a good bit of this—I think we ought to be embracing that.

And I think those ought to be on the table either as a recommendation or something the committee embraces because I do think we've got to revalue this. I think we're in a cycle now where your problem is only going to get worse. I don't think it's going to get better. I think it's going to get worse.

I think your estimates today are going to get blown away shortly because you're going to have a whole new set of thrifts, a whole new set of property that's going to come on because there's nothing that's breaking it right now.

Mr. Chairman, I'd like to ask you for the record, there is a statement in the Secretary's testimony which I really don't have time in 5 minutes to inquire on. I think it's important for the committee.

On page 3, he says, our loss estimates are based on a cashflow model that permits us to vary a number of assumptions, to take into account their effect on the RTC's ultimate costs.

I think it's important for the committee to understand what those assumptions really are and how they interplay. And in the model itself, appendix II, paragraph 3, it says, the losses to be experienced by the RTC are estimated by applying a loss estimate or "haircut" to each of the 14 different asset types, and adding that to the negative tangible net worth.

We use three different sets of haircuts.

I really think we need to understand these haircuts. We need to understand the assumptions on which they're based, or we're not going to get a sense of what the possibilities are for the end-game here. And I think that's what we're really talking about.

I think everybody here understands that we're going to have to lay out more money. Nobody questions that. And I don't think anybody wants a process in place whereby we're making it more expensive rather than less.

But I do think it's important for us to understand those assumptions and that process and we cannot possibly make a judgment without it.

So I'd like to ask unanimous consent that the record remain open and that we be permitted to submit some inquiries in writing with respect to that, simply to amplify on that for the record so that we can understand that.

The CHAIRMAN. By all means. And I gather from your affirmative nod, Mr. Monroe, you have no problem in providing——

Mr. MONROE. I heard it.

The CHAIRMAN. No, I know you heard it, but the question of responding. You have no problem in responding to the kinds of things that have just been requested?

Mr. MONROE. Absolutely not.

The CHAIRMAN. All right. Very good.

Secretary BRADY. The appendix does, as the Senator stated, lay it out. But we would be glad to go into the assumptions behind it.

Senator KERRY. I'd simply like to understand it.

The CHAIRMAN. Good. Very good.

[The material referred to follows:]

METHODOLOGY FOR ESTIMATING RTC LOSSES

In April of 1990, the Oversight Board completed the development of a cash flow model which projects RTC's sources and uses of funds on a quarterly basis through 1996. This cash flow model gives the Oversight Board the ability to vary a number of assumptions to estimate the effect on the Resolution Trust Corporation's (RTC's) need for loss funds and working capital.

Assumptions for Number of Failed Institutions

The Oversight Board's current low estimate assumes a population of about 700 failed institutions, which includes those already resolved, those in conservatorship, and all institutions classified as Group IV thrifts by the Office of Thrift Supervision (OTS). The high estimate assumes a population of just over 1000 thrifts, which includes the 700 institutions in the low estimate, plus all institutions classified as Group III thrifts by the OTS.

Assumptions for Pace of Resolution

The cash flow model does not deal with individual institutions. Rather, total assets for individual thrifts are divided into 14 different asset types and then aggregated into tranches representing conservatorships, Group IV and Group III thrifts. The RTC's pace of resolution is selected not by choosing individual thrifts each quarter, but by choosing a volume of total assets in thrifts that are to be resolved each quarter. For the $90 to $130 billion range, it was assumed that the RTC would resolve $40 billion of assets per quarter.

Assumptions Behind Losses on Assets

The 14 asset types are: cash; government and agency securities; mortgage-backed securities; high yield bonds; other investment securities; mortgage derivatives; performing permanent mortgages on 1-4 family residences; other performing mortgage loans; consumer loans; all other loans; other owned real estate (ORE); other delinquent assets; service subsidiaries; and other assets.

The losses to be experienced by the RTC are estimated by applying a loss estimate, or "haircut" to each of the 14 different asset types, and adding that to the negative tangible net worth and accumulated operating losses (prior to receivership) of the resolved institutions. In making estimates, three different sets of haircuts were used. The medium haircuts were based upon the FDIC Division of Research's bank failure cost model, and, thus, were based on the actual loss experience of the FDIC. The other two sets of haircuts were assumed to be higher

and lower, depending on the estimated effect of changes in interest rates, the condition of real estate markets and the general condition of the economy. The weighted average haircuts for these three scenarios ranged from about 13 to 25 percent, as follows:

Three Haircut Scenarios:

	Low	FDIC Model	High
Weighted Avg.*	13-14%	16-18%	22-25%

* Weighted average haircuts are given as ranges because they vary depending upon the asset mix of the particular population estimated to fail. These ranges are for the Oversight Board's low and high population estimates. The Oversight Board has preferred not to disclose the haircuts on individual asset types out of concern that they could be used by buyers against the RTC during negotiations.

Present Value Estimates

In the May/June testimony, the Oversight Board estimated that the cost of resolving all institutions that will come to the RTC would be in the range of $90 billion to just over $130 billion, in present value terms.

Our current estimates suggest that the RTC's ultimate costs are still in this range. These estimates use a discount rate of 7.38%, which was the rate the RTC paid for working capital funds from the Federal Financing Bank during late-1990 (when these estimates were originally made).

Data Used

The estimates in the May/June testimony were based upon year-end 1989 data, with the OTS Group III and Group IV classifications as of the end of April 1990. As OTS has released new data and thrift classifications, this information has been incorporated into the cash flow model. The latest estimates, upon which the President's budget numbers are based, use June 1990 data. OTS has only recently released September 1990 data and new Group IV and Group III classifications; based upon preliminary analysis, it appears that this new data will not substantially change current estimates.

Assumptions for Assets Passed to Acquirers

The cash flow model allows the Oversight Board to change the percentage of institutions that are resolved in whole bank, clean bank and liquidation transactions, and to define each of these transaction types in terms of the percentage of each asset type that is passed to an acquirer. The Oversight Board's current estimates assume that the RTC will pass an average of about 32% of all assets to acquirers.

Assumptions for Pace of Asset Sales

The model also allows the Oversight Board to vary the pace of sale of receivership assets by estimating the percentage of each of the 14 asset types that is sold each quarter until all are sold.

	1st Half Yr. 1	2nd Half Yr. 1	Yr. 2	Yr. 3	Yr. 4	Yr. 5	Yr. 6+
Cash	100%						
Govt/agency	90%	10%					
MBS	60%	30%	10%				
Perm 1-4s	25%	15%	20%	20%	20%		
Othr Perf Mtgs	7%	4%	14%	20%	20%	20%	15%
Consum Lns	15%	10%	40%	30%	5%		
All Othr Lns	7%	4%	14%	20%	20%	20%	15%
Junk Bonds	15%	10%	30%	30%	15%		
Othr Invest Sec	25%	20%	35%	20%			
ORE	0%	4%	14%	20%	20%	20%	22%
Oth Delinq Asst	0%	4%	14%	20%	20%	20%	22%
Service Subs	0%	10%	25%	40%	20%	5%	
Derivatives	25%	20%	35%	20%			
Other Assets	10%	10%	25%	30%	20%	5%	
Weighted Avg.	19.4%	11.0%	18.3%	19.5%	16.0%	8.6%	7.2%

Effect of Interest Rates

No specific interest rate assumptions were used. It is extremely difficult to estimate with any precision what effect a change in interest rates may have on the value of any given asset type. For example, if everything else were held equal, a decline in interest rates would increase the value of some assets held by the RTC, such as securities, mortgage loans, etc. However, as interest rates have declined, other economic factors which influence RTC asset values have also changed. If real estate values fell at the same time as interest rates fell, the effect on the value of RTC assets could go either way.

Because the effect of these factors is virtually impossible to accurately predict, the Oversight Board estimates are for ranges of both the number of institutions and the losses on those institutions' assets. Ultimately, the RTC's actual experience must act as a guide for any estimates. The RTC's recent experience suggests that the downturn in the economy may increase the RTC's costs. It appears at this time, however, that the RTC's costs still appear to be within our original present value estimates (though perhaps somewhat higher within this range).

RTC Projections

The Oversight Board staff developed a cash flow model in order to perform sensitivity analyses, to make cost estimates, and, perhaps most importantly, to render an independent judgement regarding RTC projections of funding needs. In other words, the Oversight Board does not simply accept RTC requests for funds without questioning the assumptions implied in these requests. Likewise, of course, the RTC does not depend upon the Oversight Board for its projections of funding needs. Rather, the RTC makes its own independent estimates based upon market conditions and the institutions likely to be resolved during a particular period of time.

The projections contained in this testimony and in the President's budget reflect what the Oversight Board, the Administration and the RTC, in consultation, believe are reasonable estimates, given that the RTC receives additional funds to cover losses in a timely manner.

Senator KERRY. And Mr. Secretary, I'd like to take the opportunity if I can to ask you if you would be willing, Senator Dodd and I and the rest of the delegation—I know you're awfully busy—we would like to be able to meet with you in short order, perhaps, really in a constructive dialogue. I think there may be some suggestions we'd like to set in front of you for your consideration as administrative ways that we think we might be able to address some of these questions, without abusing the concept of the forbearance issues and others.

I think it would be worthwhile if you would be willing to do that, Mr. Secretary, if we could.

Secretary BRADY. [Nods in the affirmative.] Senator, I would note that we have met with any number of groups. I haven't personally met with you or Senator Dodd, but I've met with numerous other people in the Congress myself——

Senator KERRY. I'm aware of that.

Secretary BRADY [continuing]. And I know that our staff has been meeting back and forth.

Senator KERRY. May I say to you that there is no insinuation here that that's been difficult to do or that it hasn't. We're just asking for it now and we'd like to do it.

Chairman Greenspan, there are a lot of RTC questions, and that's what we're really here for. But I thought you made a most important statement in response to Chairman Riegle about the relationship of the current M-2 and the interest rates and so forth.

I'd just like to ask you a couple of things if I can. What sort of timeframe are you operating on for the judgment that you say you're now making? You're watching this very carefully and you don't want to lay strategies out now, but what sort of timeframe are we operating on?

Mr. GREENSPAN. Senator, I'd just as soon not respond to that specifically because that does have market implications. I'd just prefer to say that, obviously, we're pressing the issue as readily as we can.

The specific timeframe will develop within shorter rather than a longer period because, as I said, I don't think that time is necessarily on our side. We have to move ahead to find out the cause of this process which is degenerative and to get a handle on it in a manner which can turn it around.

And it's not simply a money supply issue. I don't want to give you that impression.

Senator KERRY. I understand that. I realize that.

Mr. GREENSPAN. The money supply is merely an indicator of the extent of the process in a certain respect. But there are many other factors which are clearly involved in the disinclination of commercial bankers to lend to otherwise creditworthy customers.

Senator KERRY. My next question was going to be is there any other time in the modern history of this country that the money supply has been decreasing and interest rates have simultaneously been falling?

Mr. GREENSPAN. For short periods. But if one looks at the most recent period, the deviation is as large as I recall it.

Senator KERRY. My time is up.

The CHAIRMAN. Very good. Senator Heinz?

Senator HEINZ. Mr. Chairman, thank you.

I'd like to return to the very big picture and then narrow it down as concisely and quickly as we can in the amount of time I have, which is not much, 5 minutes.

The CHAIRMAN. May I just say one thing? Secretary Brady has indicated to us that he must leave at 12:50. I'm going to continue on with those who can remain until everybody's had an opportunity to go through the things they wish to raise.

But just so that everyone's on notice and the questions that might go to him might be done before that time.

Senator HEINZ. Right.

Secretary BRADY. Senator Riegle, excuse me. I'm supposed to be the lead speaker at a savings bond lunch, which I take as a very important project because of the nature of it. But I'm sure they can get along without me. I'll just go when we finish and make my apologies, so I can stay for some period of time.

But I'd like to at least appear at the end of that lunch to tell them how well they're doing.

The CHAIRMAN. Thank you. We'll be sensitive to your time. Go ahead.

Senator HEINZ. Mr. Secretary, as I understand your testimony, you anticipate that total losses to the RTC will approximate $67 billion by the end of fiscal year 1991, and that in addition, you'll need $100 billion worth of working capital by the end of fiscal year 1991.

Do I understand your testimony correctly?

Secretary BRADY. I'm going to ask Peter to give you the exact figure. I don't think that's quite it.

Mr. MONROE. Senator, losses as of——

The CHAIRMAN. Would you pull that microphone a little closer?

Mr. MONROE. Excuse me, sir. Losses as of the end of the calendar year by the RTC were $37 billion. We have $50 billion of funds, in a sense, available for those losses.

So during the next 9 months, the remaining $13 billion will be spent, and then there will be a need for an additional $30 billion of appropriations.

So the total losses actually incurred during the period will be $43 billion. But the incremental funds needed are $30 billion.

Senator HEINZ. So the $30 billion does not just cover the losses.

Mr. MONROE. The total amount of losses through the end of the calendar year would be $80 billion. For the fiscal year, it would be $80 billion—$50 billion plus $30 billion, total.

Senator HEINZ. Is that through the end of the calendar year on the fiscal year?.

Mr. MONROE. Fiscal year, September 30, 1991.

Senator HEINZ. I understand that you need money for working capital and to cover losses. I'm not quite sure I understand the math because if your losses are $37 billion through the end of the calendar year just ended, and in the Secretary's statement, he says you will need $30 billion to cover losses for the remaining part of the fiscal year, as I look at $30 billion and $37 billion, I get a total of $67 billion.

Where am I off on losses?

Mr. MONROE. The total losses would be $80 billion.

Senator HEINZ. OK. Where's the difference?

Mr. MONROE. We have $50 billion available now. We've spent $37 billion. The $13 billion is already available in that sense, and then we need an incremental $30 billion.

Senator HEINZ. OK. So you anticipate total losses for the rest of this year not of $30 billion, but of $47 billion.

Mr. MONROE. $43 billion.

Senator HEINZ. $43 billion.

Mr. MONROE. $37 billion plus $43 billion.

Senator HEINZ. $43 billion. Excuse me. All right. In addition the RTC needs working capital.

Mr. MONROE. Yes, sir.

Senator HEINZ. If I add those two numbers together, what numbers should I come up with, losses and working capital?

Mr. MONROE. Well, if you add all losses where we already have funds, you'd have $43 billion plus $47 billion, which would be $90 billion.

Senator HEINZ. OK. I'd like to see if I understand——

Mr. MONROE. May I make a point just of clarification, sir?

Under the change, under the statutory interpretation of the obligation limitation within FIRREA, we have the ability to borrow that $47 billion working capital. So, in a sense, we're really not asking for that. That is available.

The only thing that's really being asked for today is the incremental $30 billion. That is what the RTC is asking for.

Senator HEINZ. I understand that. But I'm trying to figure out not what you're asking the Congress for. I'm trying to ask what the losses are, which in the final analysis, is real. I'm also trying to find out what you'll need in the way of working capital because somebody somewhere in this town has to get that from somewhere. Where we get it from are the capital markets, and by bidding up the price of, bidding into those markets to get the money, we bid up interest rates, which I know Chairman Greenspan professes some concern about. I know Secretary Brady also has a great deal of concern about, interest rates.

Now, I honestly worry that, in spite of all your best efforts and I know you try very, very hard, that we don't have a handle on the ultimate cost.

I don't say that to fault anybody, but, as you know, we have had over the last 5 years this series of increasing estimates and now here we are with several years yet to run resolving thrifts and we're saying, it's going to be at or just below the upper end of this most recent estimate.

Secretary Brady is asking for an unlimited draw. Therefore, there is circumstantial evidence that even you aren't certain that you're going to be limited to less than $130 billion in losses, and I understand why. Just because an institution is resolved doesn't mean that you aren't continuing to take huge losses on it.

As I understand it, the Federal Government in the person of the RTC still owns two-thirds of the assets of so-called resolved thrifts on which the Federal Government has to borrow money. In effect, we paid off the depositors. We paid an institution to take the deposits. It's the same thing for all financial purposes. The result is that with those two-thirds of those assets, we are incurring the interest

cost of the borrowed money to carry those assets. And those are losses.

And those assets tend to be the less good assets. They tend to be those things that you couldn't sell quickly. They tend not to be your class A office space or your performing one-to-four family mortgages, which are relatively marketable.

And I worry, therefore, that not only does the length of time we're unable to make progress in selling off those assets add to the total tab, a process that is made all the more difficult by a recession, which we are clearly now in and which on a regional basis is horrendous, but in addition, that the assets which you carry at gross book value—that is to say, what the optimists or crooks in the S&L industry originally recorded those assets down as book value at—that our estimates in fact as to what those assets are worth is either somewhere between hopelessly unknown or hopelessly optimistic if we think we know it.

Mr. Chairman, I note the little red light. That means my time has expired.

I would like to submit some very specific written questions for the record. If I am able to be here at the conclusion of everybody else's round, I will attempt to pursue this line of questioning further.

The CHAIRMAN. Very good, Senator Heinz. Thank you

Senator Sanford.

Senator SANFORD. Thank you, Mr. Chairman.

Let me pursue just a couple of other lines of thought.

INSURANCE PAYMENT OBLIGATIONS

Of the funds that we are spending in the S&L clean-up, particularly on the RTC, how much of that goes for paying depositors their insurance and how much of it goes for other things, such as liquidating the property?

How much of this money is actually going to our insurance obligations?

Mr. MONROE. Yes, sir. When we resolve an institution, we are honoring all of the liabilities that we're required to honor, which include deposits. We've protected——

Senator SANFORD. What are they other than deposits?

Mr. MONROE. Other creditors of the institution, many of which the liabilities are not honored by the RTC, subordinated debt, things of that nature.

But the primary—and I'd be glad to submit something on that—the primary liability that's honored are the time resolution and deposits.

[Response to Senator Sanford's question follows:]

When a resolution takes place insured depositors are made whole. The resources to accomplish this are a mix of the assets of the institution, premiums paid by acquirers, and, to the extent these resourcese are insufficient, RTC funding. All of these resources, including RTC funding, are necessary to make good on the promise made to depositors through deposit insurance.

RTC funding for the liquidation of property is an integral component of making the depositors whole. Funds provided directly or indirectly to depositors are considered to be either loss funds or working capital. Working capital, the funding for liquidation of property, represents a short term financing of the institutions assets until such time as they can be sold. When the assets are sold, the RTC and other

claimants on the receivership are repaid in whole or in part on their claim. The funding for liquidating property is necessary to provide current cash to depositors in accordance with the government's insurance commitments.

When all is said and done approximately 99.7 percent of all RTC expenditures are paid either directly or indirectly to depositors. The remainder represents unreimbursed administrative costs.

Senator SANFORD. Of course. But how much?

Mr. MONROE. $112 billion, as I understand it, to date of deposits have been honored in the resolution process.

Senator SANFORD. And how much have we spent for other purposes?

Mr. MONROE. That's the primary—I could get you the break-out. That's by far the bulk of the spending that we incur, is for those deposits.

Secretary BRADY. Senator Sanford, obviously, the cost of running the RTC and the Oversight Board would be added to that. That money has to come out.

Senator SANFORD. What I'm mostly concerned about is how much money we are spending by holding inventory and by not disposing of property.

Are you really restrained there by any congressional requirements of getting appraised value?

Secretary BRADY. No, I don't think so. Go ahead, Peter.

Mr. MONROE. Sir, when we resolve an institution, we recognize the loss right then and there. And so, the RTC carries those assets on its books at fair market value. In the receiverships that exist after resolution, they carry it at book.

We currently have $59 billion of assets in the receiverships at book.

Senator SANFORD. And you——

Secretary BRADY. I think to try and answer your question, Senator Sanford, the only way you could cost-out what it's costing you to carry the inventory is to take the interest on the debt money you borrowed in order to hold that inventory. We could give you that figure.

Senator SANFORD. I just wonder if we're not squandering a certain amount of money by holding so much inventory.

Secretary BRADY. Well, I would not use the word squander. I would say, if you would amend your statement to say——

Senator SANFORD. Well, that's an old Southern term.

Secretary BRADY. If you would amend your statement to include how much interest cost does it take to carry that, we're obviously carrying whatever it costs. Whatever we have in inventory, we have to borrow the money to carry those assets.

But I would say as a general matter, the RTC in its operations isn't trying to hold the assets off the market for any reason other than they can't sell some of them at this particular time, or it takes a long time to sell some of the assets.

So we have been urging them right along to try and go as fast as they can and Bill Seidman says he's trying to go as fast as he can.

But some of the assets are very hard to sell.

Senator SANFORD. That leads me now just into two small questions. Obviously, in the limited time we have, they're more illustrative than anything else.

The figure that I had is that we have $19.4 billion in real estate. That's roughly correct in appraised value.

Mr. MONROE. No, it isn't, sir. The $19.4 billion represents the book value of all real estate assets owned either by conservatorship or by receiverships.

Senator SANFORD. After it's resolved.

Mr. MONROE. No, sir. That number is composited, both conservatorship before they're resolved and also after resolution.

Senator SANFORD. Now, there are 41,529 properties in that figure.

Mr. MONROE. Yes, sir.

Senator SANFORD. I'm impressed by the fact that 30,000 of those are worth less than $100,000, or only about $1.1 billion of the $19 billion. So that's 30,000 properties that have to be managed against 11,500 of higher value.

Are we not spending far more money than we'll ever get out of those 30,000 properties?

Mr. MONROE. I believe you're right. Chairman Seidman, at our last Board meeting, said that he was proposing a massive sale of properties that are under $100,000 in value, with a lot of emphasis on making such properties, especially residential, below $67,500, available.

Senator SANFORD. We would probably save money in terms of our carrying charges and the cost of capital if we unloaded those.

Mr. MONROE. Yes, sir.

Senator SANFORD. Secretary Kemp ought to be able to get rid of those.

Secretary KEMP. I'd love to try.

Senator SANFORD. It's only $1 billion worth of houses.

The other thing is——

The CHAIRMAN. Senator Sanford, would you just yield at that point because we've had a chart made up that illustrates your point and I just want to put it up here for a second.

Maybe you can hold it up a little higher, Jack, if you would.

Senator SANFORD. Yes. Put that on the Chairman's time. [Laughter.]

The CHAIRMAN. It will be on my time. What this chart shows is the blue zone over there in the value are the properties, the total amount of the value of the assets that would be above $1 million or more.

So you can see that the lion's share of the value is there. Whereas, your point is made on the other side. The red zone are those less than $100,000 that make up the overwhelming, three-quarters.

Senator SANFORD. Surely.

I agree that we ought to get all the money we can out of this and not give away anything. I saw in Cary, North Carolina a $30 million golf course which is now reduced to $15 million.

I didn't particularly need a golf course so I didn't follow up on it. [Laughter.]

Obviously, if it wasn't selling at $30 million, it was way overpriced.

To get to my second point, I read a sentence that disturbs me a little. This is a statement that I think you made, Mr. Monroe. It

was relative to Senator Wirth's comments about property for wetlands and the like that are environmentally sensitive properties.

STATUTORY OBLIGATION TO MAXIMIZE PROCEEDS

We must be guided by the statutory obligation to maximize proceeds from its disposition of properties.

How do you define maximize? We can sit on that property waiting for the top dollar and spend a great deal more money.

Secretary BRADY. Senator, I don't believe they are. They're not sitting on their property waiting for the top dollar. But I think that that chart over there, the big blue part shows you that a good part of the properties are in high value, in terms of the total assets, are in high value units, whereas, the number of properties is in low value units, which requires an enormous amount of processing to get rid of.

So I don't believe they're sitting on them.

Senator SANFORD. I'm simply saying, we ought to be looking for ways to move it on. I hope that you will give us your advice before we have another review if there are legislative alternatives to accomplish this.

Secretary BRADY. Well, a couple of the ways that we put forward this morning are by securitizing the assets and bunching them into properties and trying to make the whole package more attractive than individual properties. Seller financing, where we have a program to advance money with a receipt of a 15 percent deposit by the RTC and the like.

Senator SANFORD. We're going to run out of time. I appreciate that answer and we'd like to follow up in the written questions because I think maybe we can be of some help.

Senator Wirth I think made some very fine points, and he's going to follow up on that and I think it does deserve an explanation. It strikes me that we're losing a valuable asset if we don't use the expertise of the Fish and Wildlife Service.

Instead of hiring a real estate person, I'd rather have someone trained in this particular kind of discipline.

But I want to make this point and see if I'm out of line with your policy. When we sell to an agency for public use and create a park or a preserve that the public continues to use, instead of selling to a developer which is the high dollar, we preserve a unique piece of property.

We don't lose money, it seems to me. The public gains. The public continues to own it. I'm thinking in particular about the piece of property, Nags Head Woods, in North Carolina. It would be a shame to lose that valuable piece of property, which could be sold for a higher price to somebody who will bulldoze it down and build condominiums. If we protect this type of property, the public gains considerably. It is a unique maritime forest.

Even if you lose a dollar, the taxpayers make money. Thus, I wonder if I'm not reading your policy wrong when you say you can't give consideration to what the public ultimately gets.

Secretary BRADY. Well, Senator, you put your finger on the extraordinarily hard balance that is required of the RTC.

To take the example of your golf course, if it could be sold by the RTC for $15 million to, even though it cost $30 million, to somebody in the private sector but, we then sold it to a park for $10 million, that means the taxpayers have got to put up the difference. The taxpayers' cost increases from $15 million to $20 million.

So when we look at it from that point of view, we also have to look at it from the other——

Senator SANFORD. It also means the taxpayers got a good bargain on a park.

Secretary BRADY. Of course. It's a question of whether our authority encompasses making that judgment. I'm not sure it does.

Senator SANFORD. As you know, I asked questions in May about the property at Nags Head Woods, which everybody wants to preserve. Yet we've still had a hang-up now for a year and a half trying to get it resolved. I hope it can be resolved soon.

I'll put that in a specific question for the record. I thank you very much, Mr. Chairman, and I'll stand aside.

[Response to Senator Sanford's question follows:]

FEBRUARY 13, 1991.

Hon. TERRY SANFORD,
U.S. Senator, Hart Senate Office Building, Washington, DC.

DEAR SENATOR SANFORD: During the Oversight Board hearing on January 23, 1991, you expressed your continued interest about the status and plans for the Nags Head Woods property located West of U.S. Route 150 and adjacent to Roanoke Sound.

As you know, the property is included within a unit of the Coastal Barrier Resource System. The property was owned by Outer Banks Financial Services, a subsidiary of Great Atlantic Savings Bank, which was placed into receivership on September 15, 1989. It was the intention of Outer Banks Financial Services to develop this property for commercial purposes as part of a joint venture. Those intentions were not consummated and Outer Banks Financial subsequently became the sole title holder to the property.

The RTC adopted interim procedures on January 24, 1991, to implement the Coastal Barrier Improvement Act of 1990. The RTC will apply these procedures as mandated by the Act in Section 10 to the Nags Head property.

Accordingly, a Federal Register notice has been prepared and will be published shortly. Following publication, there will be a 90 day period during which governmental agencies or qualified organizations may submit a "notice of serious interest." It is my understanding that at least one qualified organization intends to submit such a notice. After the first 90 day period beginning with the date of publication, the qualified organization will then have 90 days to negotiate with the RTC for the sale or transfer of this property.

The property has been appraised once. A qualified organization interested in the land submitted a bid that was not accepted. Subsequent review of the property prompted a re-examination of the appraisal, in which an environmental consultant was retained. All this occurred before the enactment of the Act. Additional re-examination of the appraisal will probably be necessary because inclusion within the Coastal Barrier system extends prohibitions on flood insurance, thus affecting the value of the property.

It would seem from this review of a complicated transaction that RTC is applying the new Act and that a qualified buyer is being given an opportunity, as the Act intended, to buy the land and thus preserve it from development.

I hope this information is helpful. Please let know if I can be of further assistance.

Sincerely yours,

PETER H. MONROE, *President.*

The CHAIRMAN. Let me ask you to take a look at that particular one and get back to us.

Senator Pressler.

RELATIONSHIP TO THE FEDERAL DEFICIT

Senator PRESSLER. Mr. Chairman, many of the things comprising the big picture have been covered here. But I just want to understand one thing and that is the relationship of all of this to the Federal deficit.

I know that circumstances sometimes compel us to make decisions that are not to our liking and are not popular. And I know that the Congress decided that this is off-budget, some of it.

But I wanted to ask Secretary Brady concerning his statement that the administration is seeking $30 billion to cover thrift losses and according to other reports, that $47 billion would be borrowed in working capital.

Now, as I understand it, the $30 billion would have to be appropriated by Congress. The $47 billion would be in 30-year bonds.

Is that correct? Is the $47 billion then off-budget and the $30 billion on-budget in terms of deficit?

Secretary BRADY. Senator Pressler, subject to correction, I believe that the funds needed for this funding are outside the pay as you go budget. They are counted in the debt but they are not subject to the caps that are now imposed by the new budget regulation.

Senator PRESSLER. Yes, because, as I understand it, the $30 billion would be funds that Congress needs to appropriate, but such funds would be counted off-budget—$47 billion would be issued in 30-year bonds, but they also would be counted off-budget.

Is that correct?

But in giving a total debt assessment, we're told that the Federal deficit by September may well be up to $380 billion. You keep hearing different numbers, perhaps $400 billion.

But if you were to give an assessment of how the deficit is affected or the liability of taxpayers, even though it's off-budget at this point, what would you say that would be?

Secretary BRADY. For the RTC's work?

Senator PRESSLER. Yes.

Mr. MONROE. Again, to repeat, $30 billion would be authorized for loss funds—47 billion would be borrowed from the Federal Financing Bank for working capital. And that would be fully collateralized and ultimately returned to the Treasury.

Senator PRESSLER. Hopefully, if all goes well——

Mr. MONROE. $30 billion is really the incremental, ultimate loss.

Senator PRESSLER. OK. That's what I was getting at. And if all goes well, the $47 billion, the bonds will be paid back if things go as planned.

Mr. MONROE. Correct.

Senator PRESSLER. Good. Let me inquire about a more technical matter on a subject in which I have an interest.

As I understand it, by July 1, we are supposed to have state-certified or licensed appraisers in place. But that probably will not be accomplished. We don't seem to be moving rapidly enough in that direction. Granting piecemeal extensions will not cure the problem.

It is a cause of great concern in the private sector—among appraisers, realtors, homebuilders, lenders and would-be homebuyers.

How does it affect your activity and how will the problem be dealt with, this problem of getting State-certified or licensed appraisers in place? And what's being done?

Mr. MONROE. This is an issue that the RTC—we have met with the appraisers, but this is basically an issue that the RTC is dealing with now. And the question is, in determining market value, which is what FIRREA requires the RTC to do, when will they use appraisers and when will they not?

To the extent that appraisers become more difficult to find because of these new statutes, they may have to use additional means to get valuations other than just use of appraisals.

So they're trying to adapt their procedures to fit this new statute.

Senator PRESSLER. The various States, you mean.

Mr. MONROE. Well, no, the RTC itself.

Senator PRESSLER. The RTC.

Mr. MONROE. The RTC has the option of not using appraisals where it's below certain levels.

Senator PRESSLER. So this problem will be worked out.

Mr. MONROE. Yes.

Senator PRESSLER. Good. Let me ask you one more question on a procedure which I don't think was covered earlier.

During the summer, it was announced that the RTC had hired an auction firm to sell more than $300 million of assets. It was to be conducted in Texas and carried via satellite across the country. It was delayed a few times.

Is such an auction going to be used or do you use auctions such as this? What are the problems that surround them?

I guess if we used this sort of an auction, it would speed things up a great deal, would it not?

Mr. MONROE. My understanding is that the RTC has no immediate plans to undertake other such international auctions. I know the Inspector General is looking at that particular transaction to try to determine basically what really happened.

The RTC is going to rely much more on delegation of assets to the private sector through the SAMDA program.

Senator PRESSLER. Through the what program?

Mr. MONROE. Through the Standard Asset Managment Disposition Agreement program that the Secretary referred to, so that, for the private sector, with the right incentives, will go out and find buyers for these properties.

Senator PRESSLER. Thank you, Mr. Chairman.

The CHAIRMAN. Very good.

Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

Secretary Brady, how often does the Oversight Board meet?

OVERSIGHT BOARD MEETINGS

Secretary BRADY. Once a month. But that's formal meetings, Senator Sarbanes. We have meetings in the Treasury of an informal nature on a daily and weekly basis.

Senator SARBANES. Of the Oversight Board?

Secretary BRADY. Not of this group, but with Treasury——

Senator SARBANES. How often does this group——

Secretary BRADY. Once a month.

Senator SARBANES. Once a month. OK. Mr. Larson and Mr. Jackson, you're independent members of this Board. The others all hold a position in the administration, but you were put on I think to bring perhaps what might be called an outside perspective or speak for the public.

Mr. Larson, let me ask you this. If you were in direct charge of selling assets at the RTC, are there any changes you would want to make in how that process is going forward?

ROBERT C. LARSON, MEMBER, OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION, WASHINGTON, DC

Mr. LARSON. As the Chairman has testified, both the RTC and the Oversight Board in establishing policy have pursued a number of changes. The three that we referred to this morning are very relevant, particularly the seller financing and authorization that's been made.

There is no question in my mind and I think in the minds of my fellow Board members or, for that matter, in the minds of the leadership of the RTC that asset disposition pace is the key issue, and it is not satisfactory, from anybody's point of view.

But frankly, the condition of the assets and the condition of the economy are such that it would be my view that a continued effort along the lines currently being pursued is the appropriate course.

The only thing that I would do is look to continue to inject into the process as much private sector expertise, knowledge and experience as possible, consistent with the public responsibility and public interest with which the process is charged.

Senator SARBANES. Well, what does that mean, that last recommendation, quasi-recommendation?

Mr. LARSON. I think there's an opportunity, and the RTC is sympathetic with this view, to involve in the staffing of the RTC people with private sector experience, and particularly experience in dealing with these assets.

Keep in mind, as we must, that real estate only comprises about 11 percent of the assets that the RTC is attempting to dispose of.

So it is not simply real estate expertise or capability that's at issue here. It involves financial sophistication, and experience with securities and other financial instruments.

I believe that there is an opportunity to recruit and attract to the RTC staff people with private sector experience and private sector expertise that would materially help the RTC deal with private sector buyers.

Senator SARBANES. Mr. Jackson, let me ask you, from your perspective as an independent member of this Board, what are one or two things you think the RTC has not done very well or could do better?

PHILIP C. JACKSON, MEMBER, OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION, WASHINGTON, DC

Mr. JACKSON. The disposition process that has been discussed by Mr. Larson and others is an exceptionally difficult one and it

would be very tempting to be very critical of the way that has proceeded.

PROTECTING THE INTEGRITY OF THE DISPOSITION PROCESS

However, the statute that the Congress passed has imposed a—yes, if I may say—a conflict that exists between the responsibility, in protecting the integrity of the process, while maximizing the return as a result of the process.

Clearly, there were some suggestions made by Senator Gramm and others that what we need to do is get some dealers out here to sell these real estate assets.

I can assure you, as someone who has spent most of his life in various aspects of the real estate business, the way the Government has to sell assets in contrast to the way private individuals sell assets is material and creates a difficulty in the process.

However, my conclusion, Senator, if I may say so, is that the care exercised by the RTC, which may be interpreted as being slowness or lethargy or not acting quickly enough, protects the one aspect that I think the Congress should recognize.

The integrity of this process is essential to protect the public's confidence in this whole large enterprise. And once we destroy the public's confidence that this will be done fairly, that there are no back doors, that there are no under-the-table deals and things of this sort, if that confidence is destroyed, in my judgment, this cost will escalate even more dramatically.

Senator SARBANES. All right. Now let me ask each of you as independent members, what is your explanation as to why the cost of this is escalating at such a rapid pace?

I mean, the Secretary about 6 months ago testified on a $90 billion to $130 billion range, but he was then sort of at the low end of that range. Now he's at the high end of that range.

Secretary BRADY. Senator, I don't think the record will show that that is accurate. I stated the range without qualifying it one way or the other.

Senator SARBANES. Well, I'll accept that, Mr. Secretary. Then my only observation is, giving us a $40 billion range is not getting us very far.

Today, you're at the high end, aren't you?

Secretary BRADY. That's correct.

Senator SARBANES. At $130 billion.

Secretary BRADY. You don't want me to answer. You want to talk to these guys. I think the range is the only thing that could have been given, sir, so I have a difference with you there.

But I'll wait until you want to continue these questions.

Mr. LARSON. I share the Chairman's——

Senator SARBANES. Do you expect the cost to go higher than $130 billion?

Mr. LARSON. I don't know. And the reason I don't know is that I have not found it possible to receive any kind of definitive information regarding the number of thrifts that will fail, and therefore come into the system.

What I do know is that far more thrifts have failed and are on the verge of failure today than anticipated 6 months ago, 9 months ago, or a year ago.

I don't know the number of failures because I do not know the ultimate result of what I consider to be the free-fall in real estate values.

I believe that we are experiencing—and many of you have addressed this morning a very appropriate concern about it—a self-fulfilling downward spiral as it relates to real estate values, in which all values essentially are viewed as liquidation values in what is effectively an illiquid business.

That is materially impacting the climate into which the RTC can sell.

So the answer, unfortunately, Senator, is the answer that the Chairman has given every time we've been here together, and that is that there are factors outside the control of the RTC, in fact, outside the control of any one of us, that are materially impacting these costs and it is literally impossible to accurately forecast.

And frankly, to establish a range is, to some degree, an act of faith.

Senator SARBANES. If I could have one final question.

Is it correct, Secretary Brady, that the number of institutions that you now perceive as in trouble has increased significantly from your testimony in May of 1990?

Secretary BRADY. Certainly, the answer to that question is yes. How many more, we could go back and refine for you. I do not have the difference in that number, but that is correct.

Ergo, the movement towards the high side of the range. Plus two factors—more institutions in trouble, lesser realization of assets, lesser realization of values on the sale of assets.

Senator SARBANES. Yes, well, that's what I want to separate out because the information I have in front of me would indicate that the number of institutions involved has not changed markedly between May of 1990 and January of 1991.

Secretary BRADY. It's my understanding and, again, I would answer you subject to correction, that the number of institutions in the range hasn't changed, but the fact that there are more institutions coming into the process now moves you towards the top end of the range.

And the effect of real estate prices declining has a double-edged effect. It not only affects your realization. When we take over the assets and have to sell them, you get less. But it also is the same reason that makes more institutions be in trouble.

So it's a double hit.

Senator SARBANES. Well, I want to then, in effect, underscore the request that Senator Kerry made of you when he went to your model and started asking for material.

I think we need, Mr. Chairman, a lengthy memorandum that analyzes all of this so we can get a grip on it.

I understand that there are factors that are outside and those need to be stated as variables that cannot be pinpointed. But we need to have some information on the number of institutions, the realization on their assets, and so forth, to give us some handle on how this is going and where it may go in terms of its cost.

The CHAIRMAN. Can you prepare that for us?

Mr. MONROE. Yes.

The CHAIRMAN. Very good. Senator Domenici?

Senator DOMENICI. Let me ask what may be a very simple question that has been answered many times here. I was struck by Mr. Larson's comment that while we are concerned mostly about real estate disposition it constitutes only 11 percent of the RTC's total asset value.

Is the percentage of assets so small because RTC has been in business long enough to have disposed of most of the real estate? Or did the failed savings and loans have a very small percentage of their assets in real estate?

Mr. LARSON. I think, Senator, this is an area in which semantics and definitions are very important.

Clearly, the S&L industry had a major preoccupation and major involvement in the real estate industry primarily through mortgages and other forms of financial lending instruments.

There are many mortgages, some performing, some not performing, in this asset portfolio, that are secured by real estate.

Senator DOMENICI. All right.

Mr. LARSON. But in terms of real estate owned, that is, the real estate to which these failed institutions have title, it's about 11 percent.

Senator DOMENICI. So the RTC is in the real estate business to a much larger extent than 11 percent if mortgages and other financial paper with real estate as collateral are included.

Is that correct?

Mr. LARSON. Well, the RTC certainly is.

Senator DOMENICI. All right.

Mr. LARSON. Yes.

Senator DOMENICI. Now let me just ask a couple of general questions.

Dr. Greenspan, when we first got involved as a nation in these S&L defaults, we were not in a recession. We had regional recessions, perhaps, and the principal ones were brought upon us by the precipitous drop in the oil prices. We also had a number of S&L owners mismanaging their institutions.

That's my version of how we got in it.

To contain the S&L crisis, will it help appreciably if we get the American economy going again?

Mr. GREENSPAN. There's no question, of course.

Senator DOMENICI. Will it help Northeastern America, also?

Mr. GREENSPAN. Northeastern?

Senator DOMENICI. Yes——

Mr. GREENSPAN. Obviously, the better the economy is, the easier it is to resolve these institutions in a profitable manner.

QUESTIONING RTC MANAGEMENT OF ASSETS

Senator DOMENICI. Might I ask, with reference to the suggestion made by the nongovernmental member of the RTC Oversight Board that we staff the RTC with professionals with business real estate and banking backgrounds——

Are we succeeding? And let me tell you why I ask it.

I am impressed with Mr. Jackson's emphasis on following the rules. The Oversight Board should appear regularly before this committee to make suggestions for rule changes to make things work better. Without rules, we are apt to be without credibility at some point. We may end up with more rules than maybe we need, but we're going to try to run this so we minimize the exposure to malfeasance.

I think one of the biggest criticisms around, and it's getting bigger, is, that the RTC is not being managed in a business-like manner. Decisions are not being made in a business-like mode, that assets are being held too long are complaints I hear from my State. And I'm not just speaking of the smaller assets that make up the blue on the right-hand side of the chart. It is important to manage an ongoing enterprise well in order to preserve its market value. If it is poorly managed while under RTC control its value can be diminished or even destroyed. If that happens, the RTC ends up recovering zero because no one wants to buy a mismanaged enterprise or business.

Situations like that are very visible in a community and can cause a lot of people to say that RTC is doing wrong and that it ought to do better.

I don't have any constructive suggestions except it seems to me the more you can get business professionals involved that know the market and who are respected in the community the better the RTC's performance and perception of its performance will be.

Are business professionals and community leaders being involved? I would just like to know if some of that is occurring.

I will close by saying, my early experience with asset disposition was that there are too many lawyers and too few decisionmakers.

We had so many lawyers involved in S&L case resolution and asset disposition that people thought lawyers were costing a fortune and running everything. The perception was that they did not want to close transactions and they didn't know what they were doing with reference to this kind of business. I used to be a lawyer. I'm not so sure I run around saying I'm a lawyer any more.

Can you enlighten us a bit on that? Are things going better?

PRIVATE SECTOR INVOLVEMENT

Mr. MONROE. Let me respond to two questions first. To what extent are we involving private sector, inviting them into the process?

Well, three-quarters of the employees now that are manning the RTC are from the private sector, rather than career civil servants. And that, combined with the fact that we are intending—the RTC, I should say—is intending within the next month to have $20 billion of these hard-to-sell assets out there in the private sector with these asset managers, that's a real involvement of the private sector.

In terms of giving them the tools, Chairman Seidman came to us and said that one of the reasons that they couldn't sell assets was because there was lack of commercial financing. And our regional advisory boards, who we listen to, also from the private sector, advised us that if we wanted to get this hard-to-sell asset program

going, we needed to give them more authority to do seller financing. And so the Oversight Board approved that policy and gave them $7 billion, of which $250 million are exclusively for affordable housing.

Senator DOMENICI. Mr. Larson, are we doing better?

Mr. LARSON. We're doing better. But if you'll indulge me, let me give you at least a private sector perspective of many of the concerns that we share.

I tell my friends who complain to me like your constituents complain to you, that they should step back and imagine that one day they woke up in charge of an organization roughly the size of Citibank, except all of the assets were lousy, that they were the result of 500 separate institutions, all with different and varying record systems and ways of describing what they did and how they did it, when accounting for their assets—and in some instances they didn't bother.

They had no employees, no office, no business practices, no procedures, no policies. And the charge from their employer was to get rid of those assets as quickly as possible, close down the failing banks, save the ones that didn't fail, and do it in a fashion that minimizes the cost to the American taxpayer. And by the way, do it in a fishbowl, in which not only the administration and the Congress, but in fact the whole country was watching over your shoulder and second-guessing your judgment.

That is not an unfair description, in my mind, of what we asked the people at the RTC to do. Not us, but the people at RTC.

Against that reality, I think the performance has been amazing, which is not to say that it's been satisfactory, or that there haven't been huge mistakes, but I think it's been amazing.

And I believe that the RTC, under Bill Seidman and David Cook's leadership, have put in place both the people and the procedures that will deal in this environment with this problem.

We now, I believe, are at a somewhat different point, and I think you are beginning to see, an improvement; I would urge each one of you to go back and get current feedback from your constituents because, frankly, the quality of feedback I'm getting is better today than it was 2 or 3 months ago.

I am getting compliments about the RTC's handling of transactions today, and I never used to hear that in the field.

But it has now shifted, it seems to me, to the point where the infrastructure is in place and what we have is the biggest work-out known to man.

I believe there are different mentalities, different experience bases, different techniques, and, to some extent, different people that can manage that phase of this resolution process.

And I would suggest just one example. And that is the one to which the chairman referred earlier in the testimony, where the RTC has concluded that 75 percent of these assets constitute 10 percent of the value. And therefore, it would seem that it makes sense to prioritize the disposition almost at any cost of that 75 percent of the volume in order to concentrate the real time and energy on the 90 percent of the asset value.

That is precisely what they are doing. They have represented to us that within the year, they are putting programs in place that will eliminate that 75 percent of the asset base.

That's my view of how you approach a work-out.

Senator DOMENICI. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Senator Dodd?

Senator DODD. Thank you very much, Mr. Chairman. And Mr. Larson, you're addressing part of the question that I was going to raise.

Maybe I'm a bit different here in that sense. I don't see the RTC as being sort of a Century 21 operation, although it may be a good name for the operation if we continue the pace we're going, I suppose. [Laughter.]

UNLOADING PROPERTIES AT FIRESALE PRICES

But the idea that you've got to engage in firesale activities here is to me unwise. Anecdotally, you've got to be careful. I recently heard about some properties in the Southwest where a buyer told the principal financier that if these units were selling at around $30,000, he'd be marginally interested. The units were originally book-valued at somewhere between $60,000 and $70,000 each. They were selling at $7,500 a unit when the sale occurred.

I don't know how accurate that story is, but to the extent that the RTC is getting rid of properties at substantially less than book value, I am worried.

I don't see any reason why you have to rush to unload properties. In effect, in many cases, you create a self-fulfilling prophecy of a downward spiraling market. If you put up a chart or a map here in terms of geography where the properties were, I suspect in many areas whether a property was one that belonged to a failed thrift or was actually a market, every other house in the area has a for sale sign on it and you're trying to unload properties in that environment. It's just crazy.

Is there any sense that we must rush? Do you feel that you've got to rush to unload these properties? Isn't it wiser in some cases to wait for a better environment to emerge, a better real estate market to emerge, than it is to sort of rush to get rid of these properties?

Secretary BRADY. Senator Dodd, I think in two respects, you've put your finger on the conflicting responsibilities that we have, that the RTC has, which is not to go so fast that they destroy real estate, but not to go so slow that they build up assets inside a Government organization which deteriorate faster there than they do in the private sector.

Second, the obvious answer to your question is the more real estate that we have inside the RTC, the higher our working capital requirements are, the more money we have to borrow from the public, the more we have to come back and visit with this committee about the process by which we do that.

Also, the longer we hold it, the bigger the loss. There isn't any question in my mind the quicker that you can get it out to the private sector, the less loss that the RTC will incur and the lesser amount of loss funds that we'll need.

At that same time that you do that, you put pressure on the market and create your own fulfilling prophecy.

Senator DODD. I agree with that. I think you've hit it on the head. But let me just ask you about some specifics. As I understand it, Lamar Kelly, who testified here back in September, said that there was $3 billion in land that had been sold that represented the best land owned by the RTC.

What was the book value of that $3 billion?

Secretary BRADY. I can't give you the answer to that question. Maybe Peter Monroe can.

Senator DODD. All right.

Secretary BRADY. But Mr. Chairman, with your permission, I have to speak to the savings bank luncheon and I'm late.

Can I be excused?

Senator DODD. Before you go, just one other point.

I know you know there's no comparison at all between what's happening in the commercial banks and what happened with the thrift industry.

They're really vastly different situations. I would just hope that you would get involved in this issue fast. I realize there's a lot on your plate, and I'm not suggesting that there are any simple formulations and answers out there. But the idea of letting the marketplace take care of this to me would be terribly misguided.

We'll be sitting around here with another panel of some kind or another trying to figure out how to marshal and get rid of assets in those institutions.

I'm very sympathetic to the ideas I know Treasury is proposing. But the notion of expanded powers, where we allow commercial banks to engage in real estate insurance and securities activities frankly isn't a great prospect for relief considering the condition of those industries.

And if we don't begin to do some things here that I think can be done, we're going to be in far worse shape on some of these questions.

So, really, it isn't just a New Englander speaking to you here. I know you've heard from others from the business community, in addition to the politicians and the bankers, about how desperate conditions are in New England.

The failed businesses are up 193 percent in the last year. We have 250,000 people who have lost their jobs in 2 years. We represent 5 percent of the nation's population, yet 20 percent of the unemployment in the country is coming out of those 6 States.

We're watching a situation where a year ago, large banks were lending in excess of $18 billion in the region. It's off $5 billion over the last year.

So we're watching a situation that is tumbling down. I would really urge you, whatever it takes here, to sit down and see if we can't come up with something. I think a number of ideas exist within the executive branch. You don't even need us up here to do things. You have the power under FIRREA and some of the existing legislation that would permit you to move in this area.

I know you've got to go, but I want to emphasize that point to you. I realize it's a little afield, but not entirely so.

Secretary BRADY. Thank you very much. Excuse me, Mr. Chairman.

Senator DODD. Well, could you tell us what the book value of that property is worth?

Mr. MONROE. We've asked for that information from the RTC. As you know, book itself is a little bit arbitrary in the sense that it's the value that those thrifts that got into trouble happened to put these things on for.

We can get it for you, and I can get it for you for the conservatorships. For receiverships, basically what's happening is the RTC is changing its accounting procedures and we will be able to give you that information.

Senator DODD. I appreciate that very, very much.

Mr. Chairman, I see Senator Heinz here as well, so let me stop here and thank all of you for coming.

My feeling is that you ought to get to this. I think you're doing a pretty good job.

I think we ought to do this as quickly as we can and get the needed assistance to you so that we can move on with this.

I would hope as well that you would do what you can with the media. I keep hearing bail-out as the description of this clean-up.

This is not New York City. It is not Chrysler. We're not helping out a single bank officer, bank director, bank official. Many of them are properly being prosecuted.

These are resources that are going to depositors, and that is not a bail-out. That's a contract. And every time that a newspaper or television station or radio station calls this a bail-out, they do a great disservice to what we're trying to do here.

It creates a totally false illusion in people's minds about what our obligations are here. And that is going to make our job and your job that much more difficult.

This is not a bail-out. To call it a bail-out is factually incorrect and does a great disservice to what we're trying to accomplish here.

FREEFALL IN THE REAL ESTATE SECTOR

The CHAIRMAN. I want to raise one question. I know Chairman Greenspan has to go here. But sometimes it takes a long time to get down to where we really sort of need to nail a point or two.

Mr. Larson, you describe a downward spiral in the real estate section that is very alarming and I gather is something we haven't really seen in this country on this scale, probably since the 1930's.

I mean, you've been in this game a long time. Have you seen anything else like this?

Mr. LARSON. No, sir.

The CHAIRMAN. And I think the banks, because of their unique problems, are in a sense behaving in a fashion that adds to the acceleration on the downside, not that they intend for that to happen or that anybody intends for that to happen, but that's just what takes place.

I conclude from what you've said today and other information that we have that this is really a dangerous economic condition. I

mean, can we allow this kind of a freefall in real estate values to continue?

Is that in our national interest? If this situation is still headed down in that area, aren't we called upon to try to find some way to break that fall and level it out?

Mr. LARSON. It's my personal opinion, with the possible exception of what's going on in the Persian Gulf, that it's the most important single issue facing you in the Congress and the administration and the American public.

I believe it goes well beyond real estate in its implications and is a set of circumstances that can be addressed in part legislatively, but in fact, I think the Senator is absolutely right. There are administrative, executive and regulatory initiatives that are shorter term and appropriate here, too.

The CHAIRMAN. Well, my question is this. I take it that what you're saying, and you carry an important public responsibility here, is that this kind of a dynamic is really a dangerous dynamic and that it's out there and it's worsening.

Is that what you're saying?

Mr. LARSON. That is my observation in general, it is my observation as a member of this Oversight Board, and it certainly is my experience as a businessman dealing with it day to day.

The CHAIRMAN. Now, Mr. Greenspan, do you dissent from that view? Is he right on this, first of all, in his assessment?

I mean, I think we're getting an independent view from an expert, in a sense, who's out there who's telling us we've got a downward spiral that is continuing.

Do you agree with that view or do you dissent from that view?

Mr. GREENSPAN. Well, we have to be a little careful to be very explicit as to exactly what's happening.

To a substantial extent real estate values, as we appraise them, are coming down. What is not clear is the extent to which that is caused by the fact that we are moving, as Mr. Larson said earlier, toward a liquidating value of real estate as distinct from what I would call a longer term operational value of the assets themselves.

If you move from a real estate operation in which by the very nature with respect to lending you are lending on a nonliquid asset—in other words, a commercial bank, for example, in its lending is very purposefully making illiquid loans.

That's what its job is. If it weren't doing that, it would be an investment bank.

To the extent that you put on the appraisal process a liquidating value requirement, what you are doing is asking what will the value of this asset be not in operation, but in a forced sale.

And since every piece of real estate is by its own nature unique, it is very difficult to get a fluid market where you can get assets readily sold in the same sense that wheat or corn or copper or oil are sold.

And one of the problems that we do have is that we are purposefully or inadvertently moving increasingly toward a liquidating value sense of real estate appraisals. And that process itself is creating, in my judgment, a significant difficulty in the system.

There is no question that if you look out over the longer term, that a number of the properties which are being downward graded should be. I mean, they just do not have the potential for the values that a number of people originally put them in.

But if you superimpose the valuation process on top of the actual economic change, you get a rather dramatic effect. And while I wouldn't be as concerned about the real economics that are involved that Mr. Larson has expressed, I do think he is raising a question which has got to have our attention. And I think it's increasingly become a problem which goes beyond the standard view of how real estate weighs itself in the economy because even though commercial construction is little more than one percent of the GNP, because it's essentially long-lived assets, it is a very significant part of the gross asset stock of the economy and therefore, a significant part of what collateral is available for our financial institutions.

And it's in that context where the problem lies in the evaluation process and it's there we have to have a much better understanding of what's going on, and to try to find a way to rationalize it and prevent it from becoming the type of problem which Mr. Larson is concerned about.

The CHAIRMAN. I think what I hear him saying—I'm going to finish with this and go to my colleagues—and that is that I hear him saying in unvarnished terms that you've got a downward spiral going on that we haven't seen in decades.

It's very real. It's getting worse, not better. And the question is can we break that downward spiral? And there is this cross connection into the banking system and the weakness in the capital structure banks and that's accelerating this.

BREAKING THE DOWNWARD SPIRAL IN REAL ESTATE VALUES

What I'm concerned about is whether the Fed by itself can contemplate or take actions that can break this downward spiral.

I know you're trying to do that and it sounds to me as if, as you're testifying today, that there's new data that tells a somewhat more distressing picture in terms of this being an atypical kind of a situation and not one that we've seen in recent history.

But I'm concerned about two things. No. 1, are there things available to us that we can do that break this downward spiral and level it out, that perhaps we should be doing? Or, No. 2, is this situation gaining momentum that's beyond the tools that you have available to you to take and to try to do something about it?

Do we have to look beyond just what the Fed can do here?

Mr. GREENSPAN. Well, I can't answer that specifically. But I will tell you that others beside the Fed are looking at this particular problem.

The CHAIRMAN. I understand there is. But tell me about, I want to hear a little more fully as to your assessment and what we're likely to see in terms of your view of what you can do or what you and the Fed together can do here to break this spiral.

I mean, he's saying the red lights are flashing. Do you agree or disagree? I want to know what more can be done about it.

Mr. GREENSPAN. I would say that the lights are amber. I would not say that they're red.

I would not characterize the situation in the terms that Mr. Larson because I don't think it is at that level of a problem. I think it could become one, and it's important that we fend it off before it gets to that particular level.

But I do think that it's important to distinguish to what extent it is a self-made problem because, to the extent that we are inadvertently beginning to appraise properties in a manner which reflect increasingly business strategies with respect to real estate which were not the purpose of the original investment or the basic purpose of the original loans, we are going to create a problem where one does not exist.

We have to separate the deterioration in real estate which is long-term, real, based upon the potential flow of rental incomes, and the nature of the markets without the question of how they are appraised, how they are evaluated, and how they introduce themselves as collateral into financial intermediaries.

Those are two separate issues. The second one is the one which I think we have to focus on most specifically now.

We have very poor data on prices of real estate. We have been endeavoring to get a much better feel. We do have obviously residential real estate prices because we do an innumerable number of transactions, in both existing and in new home sales, and we can make a number of adjustments which tell us what the values of one-to-four family residences are.

And those data do suggest that there's been some decline in the upper end of the value process. But when you adjust to the normalized size of the house, we have not seen any significant value deterioration in those properties.

Commercial properties are something else again and there, the data are very poor and we're trying to get a much better sense of what is involved.

It is a relatively small part of the economy, but it is large enough because it constitutes a significant element of the collateral in our financial institutions to create significant problems for us.

The CHAIRMAN. Senator Mack.

Senator MACK. Thank you, Mr. Chairman.

Your questions went to the area that I was interested in and I particularly was, my attention was rattled when Mr. Larson said freefall of real estate values.

I just want to pursue——

Mr. GREENSPAN. Are you finished with me, because I have an appointment?

Senator MACK. Yes, go ahead. I think you probably have responded enough here. I'm just going to pursue this thought.

The CHAIRMAN. We would all like to take you over a couple more jumps and you're probably just as anxious to leave and I understand that. And you've got all the piranha over here waiting to bite into you before you get out the door.

Senator MACK. Maybe we shouldn't let him go yet.

Mr. GREENSPAN. But I'll be back.

Senator HEINZ. If the Senator would yield for 15 seconds, without losing any of his time. I just want to make a brief statement that I wanted Alan Greenspan to think about. And it's this.

We have in the Oversight Board here what you might call the inside directors. I know some of you are from the outside, but the moment you sign up with the Federal Government, you're an insider.

Sorry, that's the way it is. But who counts?

Mr. Chairman, it seems to me that the committee has not necessarily—I could be wrong—availed itself of additional outside expertise. That takes nothing away from the new and outside Board members of the OTS. When I say that perhaps it would be worthwhile hearing from other recognized experts in the real estate field, both practitioners, presumably those without axes to grind, as well as academics.

I make that comment now simply so that Alan Greenspan before he leaves can think about it and I thank the Senator from Florida for yielding on my time.

The CHAIRMAN. Thank you. Senator Mack?

Senator MACK. To pursue the thought, I guess really without getting into my theory of what happened to real estate values, it seems to me that the beginning of the whole S&L crisis really began with a turnaround in the constant escalation of real estate values. And over a period of years, many years now, we have seen movement really kind of from the real estate market into, you might say, the financial instruments market.

Again, a continual decline in real estate values.

Going through that, though, in the discussion this morning, the thought was triggered that when I first came to the Congress back in 1983, it was just after a rather significant piece of legislation was passed having to do with the change of the tax law, and I recall there was a rather significant and generous treatment of real estate with respect to depreciation schedules.

If I remember correctly, either in 1983, 1984, or 1985, there was a modification. People recognized fairly quickly that we may have overreacted in those depreciation schedules and the law was changed.

Then in 1985 or 1986, we passed the Tax Reform Bill which then again modified the treatment of real estate and what comes to mind is passive loss treatment.

What I'm getting at, I realize that I've kind of narrowed the focus here a little bit, but I think it's kind of a follow-on to what Chairman Riegle was asking.

Is there something that we ought to be doing from a tax standpoint or other policy positions that the Congress ought to address that will do something to turn around this fall in the value of real estate?

REAL ESTATE TAX ISSUES

Mr. LARSON. Well, Senator Mack, I think the answer to that is yes. I think your recollection of history is the same as mine. There was clearly excessively favorable tax treatment for real estate in

the 1981 act that created the need for what I would consider to be a very severe reaction to those excesses embodied in the 1986 act.

Although it's my personal opinion, and to the best of my knowledge, this Board has no opinion as a Board——

Senator MACK. Say that again. I'm sorry. I didn't hear you.

Mr. LARSON. I said I'm talking personally. I do not think this Board has addressed tax issues as a Board and therefore does not have a policy position on real estate tax issues.

But I do not believe that it is desirable for RTC properties to be singled out for distinctive or special tax treatment. I think that's bad public policy and would have long-term implications for a short-term problem.

But I do subscribe to the earlier views regarding the potential impact of a change regarding capital gains. I think the record is pretty clear on that.

And I do find as a practitioner that the passive loss provisions which, to the best of my knowledge, were inadvertent—that is, the real implication of the passive loss rules were not intended, and certainly, the consequences that are now apparent were not intended—that should be addressed by Congress. I think you would find that it would have a materially beneficial effect on the people on whom we must rely in the last analysis to deal with the question of real estate values and RTC properties and work-outs.

Senator MACK. Let me make a suggestion and I'm sorry that Secretary Brady is not here. But Peter, if you would pass on to him the suggestion.

Because, again, your comments triggered in my mind that if my perspective is right or at least if my perspective plays a major role in what is driving up the cost to RTC and then therefore to the taxpayer, if it in fact is related to the kinds of positions that I have been pursuing here this morning, whether it's capital gains or whether it's depreciation schedules or passive loss, it would seem to me that it would be of significant value to the Congress and to the Nation if the RTC were to consider as a board or as an oversight board, rather, pursuing the discussion of what tax policies have to be changed, if any, or if other policies affecting the value of real estate in this country need to be addressed in order to shore up the value of real estate.

And I guess another way of saying that is that to make it attractive again for someone to invest in real estate.

So I would hope that that message would be considered by the Oversight Board. If it is a very significant cause of the problem, then it seems to me that's something that is very appropriate for you all to address.

I realize that what we're asking you to do is get right into the middle of a political battle.

But welcome.

Mr. LARSON. Well, I think certainly we'll take a look at it. I think a close reading of our responsibilities and authorities under FIRREA might suggest that we don't belong in the middle of that, that that is more appropriately the province of those who are responsible for tax policy.

But we certainly heard the suggestion and Peter will make sure that we talk about it.

Senator MACK. I can't help but again stress to you the importance of your willingness to make that kind of commitment and statement.

Your reaction reminds me of my attitude when I was in the banking business for 16 years. Too busy—no, wait a minute. Don't react to that. That's not a challenge to you. [Laughter.]

Too busy involved in the day-to-day operations of making sure that my business, your business is operating correctly, and allowing the political decisions that affect my life to be made by somebody else.

I've just got to tell you that RTC Oversight Board has an opportunity, and I think an obligation, to make a statement about the kinds of policies that are affecting the value of real estate and therefore, the eventual cost to the taxpayer.

Mr. LARSON. I wouldn't pretend to speak for my colleague, Mr. Jackson, but I will be here every day of the week, 24 hours a day, to talk to you about my views, both on tax policy as it affects real estate and, for that matter, the issues that were raised by the Chairman.

The only thing I'm suggesting is that I'm not sure it's appropriate for the Oversight Board, as a board, to be dealing with those issues.

Senator MACK. I understand.

Mr. LARSON. But we'll take on the assignment and go back and talk about it.

Senator MACK. OK, great.

Mr. LARSON. But I, for one, will not duck any participation that you all would find helpful on those issues.

Senator MACK. I didn't mean to make that as a personal challenge.

Mr. LARSON. In fact, I'd welcome the opportunity.

Senator MACK. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Heinz?

Senator HEINZ. Well, taking up where Connie Mack left off, obviously, as all of you have surmised, many of us, myself included, are very concerned about how we maximize the value here, minimize the cost to the taxpayer.

And I would reiterate the concerns of Connie Mack, the Chairman, and others about the impact not only of firesales on the real estate market where the sale is being conducted, but of course, also on the taxpayer, not just in the obvious way, which is rather than maximizing, minimizing the returns to the RTC, but on a hidden governmental cost, which is what those drops in real estate values do to other insured institutions in the area that are not in financially very good shape, and we know that there are many that are not. We know that Bill Seidman says that there are going to be more falling by the wayside.

And if the efficient cause is a further drop in real estate values because the RTC is selling a lot of properties into that market, an obscure, but very much on-budget cost to the taxpayer is the FDIC bail-out of the bank or remaining S&L.

I think we're all trying to come to grips with what all these linkages and costs are.

IMPACT OF THE TAXPAYER

As I, to the extent of my limited ability to do so, have been able to figure out the various critical factors impacting the ability of the RTC to maximize the return to the taxpayer and minimize the loss to the taxpayer, I come up with seven—excuse me—six major factors. I'm going to name them and then I'm going to ask Mr. Larson and Mr. Jackson—I'll let Peter Monroe have a nice day for a change—to give me their impression of which are the most critical.

First, and I'm sorry Alan Greenspan had to leave, Federal Reserve policy as it impacts interest rates.

Second, the budget deficit as it impacts the Federal Government having to compete for funds in the marketplace.

Third, the policy of the RTC on liquidation. To the extent it is firesale and attitude, it has more of an impact than it does not.

The decision of the Comptroller to let all banks supervised by him during the last 12 months know that there were going to be a much more rigid set of standards applied to his examiner's evaluation of real estate loans without explaining clearly to those examiners or to the financial institutions that the idea was not to have the banks start calling perfectly good real estate loans.

And finally, the impact on financial institutions generally occasioned by that. That is to say, banks in an effort to reduce their exposure to regulators coming in and saying, we want you to have more capital, that they were striking, in a sense, preemptively by calling good loans to build up cash and capital so that they could keep the regulators away from their door.

Which of those six factors—let me start with Mr. Larson—would you say would be the two or three most important ones here in the context of this problem?

Mr. LARSON. Senator Heinz, two or three most important in terms of——

Senator HEINZ. In terms of the issue that I started with, which is how do we avoid the losses? How do we maximize returns to the taxpayer in the operations of the RTC, whose overseer you are?

Are there any that are irrelevant? Let's start there.

Mr. LARSON. Well, I don't think they're irrelevant, but from my perspective, and I hope that you can understand it's a limited perspective, in the context in which you're asking the question I would minimize the point you make about the budget deficit and the resulting competition in the marketplace.

Senator HEINZ. All right. Minimize that one.

Mr. LARSON. You might find it surprising, but I also would minimize what you characterize as the RTC policy regarding liquidation.

Senator HEINZ. I'm sorry?

Mr. LARSON. The firesale concern. As a practical matter, these properties are not in the condition to be dumped or "firesaled". The titles are not clear. There is a morass of litigation surrounding them as the RTC inherits them.

I think the number of lawsuits pending against RTC properties is something over 100,000.

So that even a policy that was undiscriminating in terms of moving assets as fast as possible, would not in fact result in a fire-sale or dumping, and is not doing so.

Senator HEINZ. OK. Keep going.

Mr. LARSON. I believe that the latter two points you made are very material.

Senator HEINZ. Which ones?

Mr. LARSON. The apparent change, at least apparent to the marketplace, in the regulatory criteria, the energy that goes into bank examinations under the direction of Bob Clarkes' office and the resulting anticipation, overresponse, or overreaction on the part of banks.

I believe that it is entirely appropriate in one sense and I am fully supportive of the Comptroller in his efforts to correct what I believe were excesses in lending and borrowing over the past decade.

But to impose that psychology and that criteria overnight, to go from black to white, if you will, without recognizing its impact and the need for some kind of transition, I think both in terms of regulatory policy and in terms of time, has, I believe, created a shock which has contributed materially to the downward spiral we described earlier and the lack of confidence in real estate markets, and frankly, the materially weakened condition that real estate practitioners find themselves in today where they literally view the market with few exceptions as one in which both credit and capital are absent.

That is material, in my opinion.

Senator HEINZ. Those are important points, and I thank you.

What about Fed policies, interest rates or their open market operations that result in interest rates, or any other policies that are material to this?

Mr. LARSON. Well, we of course talked about the tax policy.

Senator HEINZ. You can speak confidentially. [Laughter.]

Mr. LARSON. I appreciate that and you've already learned that I don't speak with as much care as Chairman Greenspan has learned to do. I am learning from him, but only slowly.

Please don't misinterpret this comment as one of second-guessing Fed policy. I frankly don't think I'm qualified to do that.

But I do believe that lower interest rates are part of the prescription here and that under the circumstances, from my perspective, and from an RTC perspective—though not necessarily from an overall economy perspective—the move to lower rates has been too slow.

Senator HEINZ. Let me give you a couple of real-life—I won't contest those evaluations. They seem to make some sense to me. And unless Mr. Jackson speaks up, for the sake of time, I'll assume he generally agrees with what you said.

Mr. LARSON. That's unfair.

Mr. JACKSON. Unfortunately, Senator, I wasn't able to hear him. But I'll be glad to give you my views if you like.

Senator HEINZ. Well, I'll ask another question which you'll have a fair shot at here, Mr. Jackson.

Mr. JACKSON. Yes.

Senator HEINZ. And it's this. I know of a number of specific problems that trouble me deeply regarding things that the RTC has done.

I'm thinking in the more general case about the auction that was postponed several times and finally canceled because no one understood that the investment in due diligence that must be made is a considerable one and you don't do it in anticipation of an auction.

I'm thinking of the first and maybe the present attempt at seller financing, where, as far as I can tell, what the Oversight Board has said to the RTC is you figure out what you want to do, and if you don't do it right, we will second-guess you and tell you that you did it wrong after you've failed.

More specifically, I know of two instances where the RTC appears to be taken to the cleaners legally through its own ineptitude or ignorance or uncertainty or fear of being second-guessed.

In the case of one, at construction cost 5 years ago, a class A office building, $30 million invested just to build it. RTC received a bid of $8 million, turned it down. The developer offering the bid said, these guys are dumb. Went to his only other competitor in the market and said, let's make a joint bid at $5 million, which, as I recollect, the RTC subsequently took.

That's called a substantial diminution in value just by being dumb.

A second case is that an asset, a performing asset that the RTC inherited because it belonged to an S&L had a $5 million mortgage on it. The partnership that had the property against which the mortgage was secured went to the RTC and said—never missed a payment, mind you, but said, gee, times are really tough. We will pay off this mortgage, $5 million face value for $3 million. And you'll be able to say that's a liquidation.

The RTC took it.

When, as far as I have been able to determine, the RTC would have been paid the $5 million had they handled this better. Or at least of the $5 million.

I am concerned that something is happening out there in the field that whatever we think is going on, even assuming we had the right policy, is costing us 20, 30, or 40 percent, I don't know how many percent of what we ought to be realizing through proper execution and good management.

OPERATING AND MANAGEMENT FAILURES

And I would like Mr. Larson and Mr. Jackson to comment on how serious the operating and management failures of the people in the field probably are, which I think, in one respect, shouldn't be surprising since these are all new people. Lord knows where we're getting them. They are new to the Federal Government. They are uncertain. They are probably not the very best people in the world, else they wouldn't have been looking for a Government job as you are finding out today.

So I don't know whether it's through fear of flying, ignorance, ineptitude, or worry about being second-guessed, but I have this sense that the way we go about operating the RTC, over which you have oversight responsibility, is that we're in bad shape there.

And I'd like you to comment on your own instincts and views or knowledge.

Mr. Larson, then Mr. Jackson.

Mr. LARSON. Well, a straightforward answer to your question is I don't know.

But the question, I think, requires a much fuller answer. Initially, I would fully identify with Mr. Jackson's earlier comments about the environment, the nature of this start-up process and the need to understand, in my opinion, at least, that there is nobody who would have performed to our collective satisfaction given these facts and circumstances.

I don't know about specific examples and by law, the Oversight Board is not privy to details regarding individual transactions. So even in our official capacity, we do not see information regarding individual transactions.

There is a bit of a Chinese wall that was created by the legislation, as you understand.

But there is no question that there have been mistakes. There have been errors in judgment. I'm sure the RTC has been taken advantage of.

I would remind you, at least in my experience, that that happens in the private sector as well, that people in the private sector don't bat 100 percent all the time, either, and there are deals that are made that shouldn't have been made and people get taken advantage of.

Senator HEINZ. That's true. But I can't help interjecting that a good operator, such as I understand you were fabulous, and may still be——

The CHAIRMAN. Maybe a little less fabulous.

Mr. LARSON. I hope.

Senator HEINZ. Those average out, the good operators, No. 1.

Mr. LARSON. No question.

Senator HEINZ. No. 2, guess what happens to the bad operators? They go out of business.

Unfortunately, if you were to conclude, and I'm not saying that I've concluded that, that we had inept or bad operators working for us, they don't average out and they don't go out of business.

Mr. LARSON. Well, this could be a long conversation. I'm as anxious to hear Mr. Jackson's answer as you are.

But let me simply say that, from my perspective, there have been many mistakes and I'm sure there will be more.

My general assessment of the quality of the people is high, not low, and competent, not incompetent, though they are inexperienced in many instances.

The RTC has, in effect, created the functional equivalent of going out of business. They have addressed situations in what I find to be a meaningful way, of changing and eliminating personnel, and changing procedures and structures as they learn from the kinds of experiences you've outlined.

My final comment, Senator Heinz, would be that the Oversight Board shares the concern that you've expressed in spades. We have spent an extraordinary amount of our time informally and formally meeting with the Inspector General and with the management of the RTC and are working hand-in-glove with the RTC to ensure

that at least together we are able to get the kind of objective evaluation of performance in terms of system and procedure design, as well as transaction and deal results so that we and the RTC can make informed judgments.

And we see the Inspector General playing a very significant role in that process and that's why we have encouraged the move from a staffing that was initially planned at 100 to a staffing that by the end of this fiscal year will be over 350.

We think that that kind of talent in the IG's office is important to help the RTC deal with the reality that you describe.

Phil.

Mr. JACKSON. I would share all Mr. Larson's comments and just add this one.

Tragically, we must want them to make mistakes because that means they will have done something. And the grave mistake in this process, Senator, in my judgment, may be to do nothing.

It is better to have tried and lost, or done something wrong, than not to have tried at all under these circumstances.

And so, I guess I'm in the situation where I'd much rather have you bring up instances where they tried to do something and failed, as long as it is done with integrity, as I commented earlier, than to have not tried to do anything.

And so I guess, on balance, the public purpose is better served by, yes, the horror stories you may have already heard and which we probably will hear in specific instances in the future. But that does mean that they're doing something.

And I think, on balance, the public interest is better served by having tried that with the IG's purpose and all the rest of it to assure its integrity than to have them sit around and do nothing.

Senator HEINZ. Mr. Jackson, I couldn't agree with you more. But, as you know, each of us is in exactly the same position. You are, we are.

Every time we cast a vote, we are in the position of executing on the slogan, it's better to have tried and failed than not to have tried at all.

Mr. JACKSON. I experience this——

Senator HEINZ. Granting that absolutely unarguable hypothesis, let me just pose one last question to you with the chairman's forbearance, and it's this.

There are certain limits to your oversight. Mr. Larson mentioned the Chinese wall. Do you believe that you have all the information you need to perform the kind of oversight function that is required to minimize the exposure of the taxpayer or is there information, are there holes in the Chinese wall? Are there authorities that we should give you whether or not you have asked for them as yet—I don't know that you've asked for them to my certain knowledge—so that you could do a still better job than that you are trying to do?

Mr. JACKSON. I'll volunteer to say, not yet.

Senator HEINZ. Not yet, what?

Mr. JACKSON. Not yet. We don't yet have the total quantity of information that would make me comfortable in the responsibility that you have asked us to assume.

Senator HEINZ. And part of that is the statutory limitation or not?

Mr. JACKSON. No, sir, I don't want to suggest that. Part of that is the establishment of the inspector general's office that Mr. Larson just referred to. It is not yet up and fully staffed. And until it is up and fully staffed, obviously, we will not have that type of information that an oversight function should properly have.

Yes, I would share with you that there are some forms of reports and so forth that I am not getting yet that I would prefer to have. That comes in part by the start-up process that Mr. Larson had, the incredible complexity of it, and also what I think was a proper legislative process by which this was entrusted to an existing FDIC organization to which was appended an RTC organization with similar, but in some respects, dissimilar value systems and needs.

I can tell you, Senator, that they are moving rapidly as a result of even discussions yesterday where the FDIC is giving RTC more and more self-contained resources to provide that type of information that the FDIC didn't have the capacity to do initially, but is being developed. And I think the time will soon come when that answer will be yes, we do have the information it takes to perform our function.

Senator HEINZ. Mr. Larson, any comment?

Mr. LARSON. When I appeared here for the confirmation hearings, the chairman asked whether I understood that it was your expectation of an independent board member that if I ever reached the conclusion that legislative initiatives were appropriate to better do this job, that I would be quick to come here and be candid with you about it.

As Mr. Jackson has suggested, there is no legislative initiative that is necessary for us to increase the quality of our oversight, at the same time that the RTC increases the quality of its performance.

I would suggest to you that the two issues that have been discussed here today which do involve legislative initiative are absolutely central to our continuing to perform in the way that you would like us to perform.

One is adequate funding. And I would like to make a personal plea just so that you don't think that it's simply an administration issue.

I believe the unlimited funding request is appropriate, not because I don't think we need this kind of accountability and discipline. I think we do. But because, in my view, the blank check has already been written. The blank check was written when insured deposits were guaranteed by the Federal Government.

And that really is the requirement here. The issue in terms of minimizing the cost is not really what the liability is. The liability comes under the insurance guarantee decision. The minimization of the cost is how well the RTC does at managing that process and selling those assets that it inherits.

But it is really a cost that's established in effect up here and we are now all working together to try and offset that cost by the orderly resolution of thrifts and disposition of assets.

To the extent that the RTC can plan on a long-term basis and be in a position to execute against deal structures and initiatives that

by their very definition take a long time to evolve, some assurance of funding that is prospective—if it's not forever, at least it's far enough in advance so that there is no interruption in the orderly process in and commitment to deals—will make a material difference.

And second, all the things that we have talked about here this morning under the stimulation of the chairman regarding the current economic environment and its implications will, I believe, also require ultimately your attention and will help us materially do a better job.

Senator HEINZ. Mr. Chairman, thank you.

The CHAIRMAN. Thank you, Senator Heinz. And let me thank the three of you and your compatriots who had to leave. You've been very patient.

We don't normally run until 2 in the afternoon. I would like to ask you also, that if there are any structural changes whatsoever that you think might be worth considering, that you give us those in writing. I ask the two independent members to do that.

I'm also going to insert a statement in the record relating to a study that Mr. Litan of the Brookings Institution has put forward on an alternative way to handle this asset disposition process.

We're going to be questioning—we've asked CBO to take a look at that. They're going to be in here in a week and we'll take that up with them at that time. I would just make that as part of the record at this point.

Again, thank you very much for your answers and your hard work and your patience today.

Mr. LARSON. Thank you.

The CHAIRMAN. The committee stands in recess.

[Whereupon, at 2 p.m., the committee was recessed.]

[Response to written questions and additional material supplied for the record follow:]

CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, DC 20515

January 22, 1991

Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

This letter is in response to your request of August 17, 1990, that asked CBO to comment on the potential budgetary savings and other consequences of thrift resolution proposals offered by Dr. Robert Litan.

Dr. Litan, of the Brookings Institution, in his August 14 testimony before the Senate Judiciary Committee and a subsequent article entitled "A Clean Sweep of the Thrift Industry: Getting Out of the Thrift Crisis, Now," published in the Winter 1990/91 issue of The Brookings Review, argues for speeding up the resolution of failed thrift institutions. Based on his analysis, he contends that "at least $12 billion" could be saved if all insolvent thrifts "as well as all thrifts too weakly capitalized to survive" were immediately seized by the Resolution Trust Corporation and their insured liabilities immediately resolved. Unfortunately, the nature of the data and the state of knowledge about the behavior of regulators and thrift institutions make it difficult to fully judge the proposal and quantify any savings that it might generate. Despite this uncertainty, the general benefits of the proposal seem reasonable. Dr. Litan's analysis highlights some of the key factors that should be considered in developing a strategy to resolve the remaining weak thrifts.

Dr. Litan identifies three sources of savings that would result from his "clean sweep" proposal. First would be the elimination of the high interest (and administrative) costs of the weakly capitalized thrifts that would be resolved immediately. Second would be the avoidance of continued "gambling losses" by those thrifts. And third would be the higher franchise values potentially realized under the clean sweep, as compared to the slower-paced current policy.

To illustrate the difficulty of pinning down savings estimates for this proposal, consider the approximately $6.3 billion in "interest savings" that Dr. Litan derives for the first of these savings elements (see page 12 in The Brookings Review). Using data relating the interest and administrative costs of weak thrifts to interest yields on intermediate-term Treasury securities (which would replace the thrifts' costs under

a clean sweep) for 1989 and part of 1990, Litan concludes that yearly savings would range from $1.8 billion to $4 billion. This suggests that although the direction of the change is clear, the amount of the savings is anything but firm. Moreover, as Dr. Litan notes, the calculation omits what would probably be the major interest savings: namely, those of well capitalized thrifts that would no longer be driven to pay premium rates for deposits in order to compete with the weakly capitalized thrifts. At the same time, Dr. Litan's estimate implicitly takes the historical rate on Treasury securities as indicative of what would be paid under a clean sweep even though he acknowledges that the plan might necessitate the issuance of restricted Treasuries with unfavorable liquidity characteristics. As indicated in the detailed answers attached to this letter, we find it difficult to project the cost of such securities.

Similar reservations must attach to the other savings elements in Dr. Litan's plan. Thrifts could continue to deteriorate by offering higher rates for deposited funds, and by incurring new losses in the future on risky loans and investments made today. From an analysis of failed thrifts that have been resolved, we know that thrifts invested in riskier assets as they became less well capitalized or when their closing was delayed after they had become insolvent. Most of the analyses of the cost of resolution conclude that delay in closing institutions has significantly increased the cost of resolution.

Thrifts have funded such riskier investments by selling off less risky assets or by growing rapidly. Since the passage of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, undercapitalized thrifts have been less able to grow and/or make investments in risky categories of assets. The incentive for undercapitalized thrifts to take on a riskier investment strategy still exists, and we do not know how effective thrift supervisors have been at curtailing so-called "gambling." It is reasonable to assume that they have succeeded in preventing such deterioration to a degree, but it is equally reasonable to assume that they have not completely stopped it.

If failed thrifts were placed in the government's hands, the incentive on the part of failed thrifts to make new, risky investments would be removed. Against this, some analysts argue that net asset values might deteriorate more in the government's hands than if they remained in the private sector. This might happen if the government incurred higher costs by taking into possession a larger quantity of assets than it would if institutions were resolved under current procedures. Moreover, the government might manage the assets poorly, or lack the ability or incentive to obtain prices for them equal to those obtainable by the private sector. In addition, some aspects of franchise value depend on the auctioning of "whole banks," which would be impossible under a clean sweep.

In sum, Dr. Litan's clean sweep proposal is an interesting one that, at a minimum, should be helpful to the RTC (and to the Committee) in formulating a strategy for resolving weak thrifts in the months ahead. At this stage, the general benefits claimed for the proposal seem reasonable, but there are potential costs that have to be considered as well, and any specific estimates would be uncertain.

Answers to the specific questions you posed are attached. In our experience, cost savings involved in complex bills--and a clean sweep bill would surely be complex--depend on the details of their implementation. Should the proposal reach the stage at which a bill might be written, CBO would welcome the opportunity to do more work on it.

Sincerely,

Robert D. Reischauer
Director

Question A: What does CBO estimate to be the potential savings, if any, from implementing this proposal?

Answer

The savings generated by the proposal are not certain at this point, primarily because the calculation depends critically upon how thrift assets would be disposed of. In addition, it remains quite difficult to identify weak or economically insolvent thrifts when they are still solvent on a book-value accounting basis. Certainly, there would be benefits from a "clean sweep." First and foremost, it would force thrifts targeted for resolution to be closed immediately and prevent them from incurring further losses by undertaking new risky investments and paying premium interest rates for funds. Because a clean sweep would transfer the risk of holding assets from depositories to the government, and would at the same time substitute Treasury financing for the thrifts' private costs of financing, the overall financing costs would be less than under current procedures. This approach would have the additional benefit of removing from the industry weakly capitalized thrifts that adversely affect the operations of well capitalized thrifts (for example, by driving up the rate of interest they have to pay for deposits). The magnitude of this benefit has not yet been analyzed by either Dr. Litan or CBO. Finally, Dr. Litan argues that higher franchise values could be realized by speedy resolutions.

There are several reasons why the potential savings of the Litan proposal are uncertain. First, the proposal would be most likely to save the government money if the government realized the same real net return on the assets it obtained with early closure as it would have received if the institutions were resolved in the normal course of events (or an even better return with asset repackaging). This might not happen, however, if asset values deteriorated more under government control, or if the government was unable for other reasons (such as poor management, political pressures, or lack of incentive) to obtain prices equal to those obtained by the private sector. In addition, in taking possession of assets the government incurs costs that could be avoided if the assets were transferred to acquiring institutions under normal procedures.

The regulators claim that asset values do in fact deteriorate faster in the government's hands than they would if held privately. The government may be less able, or willing, to ensure that performing loans do not go into default; it may not maintain real property as conscientiously; and it may not be able to match the private sector's intimate knowledge of markets. These are particular risks when large quantities of assets are acquired over a short period of time.

It seems unlikely that a clean sweep would improve the government's ability to obtain compensation for the ongoing franchise value of an institution: while some value might be realized through quick sales of core deposits, other elements of franchise value, such as branch operation, employee knowledge, and supplier relationships, would be lost.

For some institutions, the Litan proposal might increase rather than decrease costs. These would be institutions characterized by a low percentage of losses relative to total assets and by slow deterioration in asset values. Moreover, by "locking in" the losses, the proposal does not allow for the possibility that some institutions that are now insolvent, on a market-value basis, may become solvent again, although most analyses conclude that such institutions are a very small fraction of the total.

Question B: How much of this saving would result from reductions in delay costs? How much would result from reductions in cost of funds?

Answer

Nearly all of the savings generated from the proposal would come from reducing the costs associated with delay, that is, costs associated with allowing ailing thrifts to continue to deteriorate.

The costs associated with allowing failing thrifts to continue to deteriorate consist largely of the so-called "gambling losses" of thrifts, that is, losses resulting from risky investments made in the hope of a higher return. If weakly capitalized thrifts continue to behave as they have in the past, they will "gamble" with their investments in an effort to restore their solvency. Thrifts, as a group, have a poor record of success in such gambles, which have resulted in greater costs for the government. The basic purpose of the Litan proposal is to prevent weakly capitalized thrifts from gambling by closing them. The Office of Thrift Supervision maintains that it can already control this form of loss through regulation and supervision. We are examining the available data closely to see whether we can verify this claim. Although we have not concluded our examination, and the data at this point are far from conclusive, gambling losses appear to be continuing, albeit at a slower pace than before FIRREA.

Some of the savings generated by a clean sweep would be expected to result from substituting Treasury financing for traditional thrift financing. On the whole, the savings from lower interest expenses would probably be small. In the case of thrifts with very low capital-to-asset ratios, the difference between Treasury financing and high-cost commercial deposits could be significant, although such high-cost deposits make up only a small fraction of the average thrift's sources of funds.

Question C: What does CBO calculate to be the weighted cost of funds for thrifts that fail to meet current capital requirements?

Answer

Properly speaking, the cost of funds to a thrift should be the interest paid on deposits and other borrowings plus the net administrative costs of servicing these liabilities. Accurate data on interest rates, maturities of borrowed funds, and other aspects of the cost of funds for insolvent thrifts are limited at best. Therefore any estimate of the "weighted cost of funds" must be a rough approximation. The cost of funds can be approximated as the ratio of interest expenses plus 50 percent of noninterest expenses to assets. We use a ratio of tangible capital to assets of less than 1.5 percent to classify thrifts as "nearly insolvent." The 426 thrifts in the nearly insolvent group in the first quarter of 1990 have an average cost of funds equal to 9.08 percent of assets, or 70 basis points higher than the average yield of three-to-five-year Treasury securities and approximately 63 basis points higher than the average yield of 30-year Treasury securities.

Question D: What does CBO believe would be the impact on the market for Treasury bonds of a one-time-only issuance of $350 billion in new obligations whose resale is restricted in the manner Mr. Litan proposes?

Question E: What does CBO believe would be the impact on interest rates of such a bond issue?

Answers to D and E

While the overall level of interest rates should stay the same, rates on Treasury debt might rise while other rates might fall. The magnitude of such a bond issue would undoubtedly be sizable in comparison with the quantity of Treasury notes outstanding. As of September 30, 1990, total borrowing by the Treasury from the public stood at $2.4 trillion. Of the total marketable debt, $1.2 trillion was in Treasury notes corresponding to the maturity of the proposed special Treasury securities. An increase of $350 billion in this category would increase the stock of notes by almost 30 percent. However, the way in which the issue would be introduced to the credit markets would ensure minimal impact. Healthy institutions would decide how much of the new deposits of failed thrifts they wanted to acquire. They would then submit bids on the special securities, just as they normally do in auctions for Treasury notes. The Treasury would rank the bids and grant the securities and deposits to those institutions willing to accept the lowest rates until all deposits and securities had been claimed. The new deposits would be offset on the institutions' balance sheets by the special Treasury securities. No new net extension of credit by the private sector would take place, implying no effect on credit flows. As a result, the new issue of Treasury debt should not put upward pressure on the overall level of interest rates.

Rates on Treasury debt might rise over time because depository institutions' portfolios would become more heavily laden with Treasury securities; yields on other assets would be likely to fall. Recognizing that all U.S. commercial banks, savings and loan institutions, and mutual savings banks in 1989 held about $615 billion in Treasury securities, additional holdings of $350 billion in these special notes might move them away from their desired mix of assets, which is based on risk and return characteristics as well as on regulatory requirements. To the extent that other Treasury securities were sold on the open market on net by the acquiring institutions in order to rearrange their portfolios of assets, yields on these securities would increase. Yields on assets purchased by the acquiring institutions would fall. For commercial banks, assets likely to be purchased would include commercial paper, other commercial loans, mortgage-backed securities, and perhaps mortgages and consumer loans to a lesser extent. Acquiring thrift institutions would be likely to purchase more mortgages. Most asset portfolio models that estimate such relative rate movements find them to be quite small, but the reader should be aware that much uncertainty surrounds the exact results. In any event, as the RTC sold the assets it acquired and retired the special Treasury issues, any relative rate movements should be reversed.

Question F. Would the acquirers of deposits under Mr. Litan's scheme demand a premium because the resale restrictions on the Treasury bond issues would pose some liquidity risk? If so, can CBO estimate how large that premium might be?

Answer

Because the special Treasury securities would be resold only to institutions that were qualified to purchase deposits of failed thrifts, there might be some liquidity risk associated with holding them, but the magnitude is difficult to predict. That is, if the acquiring institutions found it necessary to increase their liquidity, or cash holdings, in a short period of time, the limitation in the market for the special securities could increase the costs of selling those assets. The special Treasury securities might, in other words, not be perfect substitutes for other Treasury securities. To the extent that liquidity risk is seen to be a serious problem by institutions that closely monitor their liquidity and that rely on sales of Treasury securities to meet their liquidity needs, the special securities might bring a lower price (that is, a higher interest rate) from acquiring institutions. It is difficult to predict the size of this liquidity premium, but it would probably be small given the advantageous features of such special securities.

Question G: What interest rate risk would Mr. Litan's proposal create by backing variable-term deposits with Treasury obligations of, presumably, fixed terms? How can that risk be reduced or eliminated? In view of that interest rate risk, is it reasonable to propose -- as Mr. Litan proposes that acquirers of the new Treasury obligations hold no additional capital against those assets?

Answer

Dr. Litan's proposal would appear to create an interest rate risk by backing variable-term liabilities (deposits) with fixed-term Treasury securities. That risk could be minimized, however, by instead issuing shorter-term Treasury notes to allow a better match between liabilities and assets.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HEINZ FROM
Nicholas Brady

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

April 16, 1991

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Enclosed are responses to the questions submitted to Secretary Brady following his testimony before the Senate Banking, Housing, and Urban Affairs Committee on January 23, 1991.

An additional copy will be sent directly to the Committee for the permanent record.

Sincerely,

Mary C. Sophos
Acting Assistant Secretary
(Legislative Affairs)

Enclosure

QUESTIONS FOR RTC OVERSIGHT BOARD
FROM SENATOR JOHN HEINZ

Q1. On December 7th the Oversight Board authorized a $7 billion seller financing program for RTC assets. The RTC could provide this seller financing when commercial financing on acceptable terms is unavailable and the use of seller financing will increase the net present value to the RTC.

Q1(a). The Oversight Board had previously authorized $3 billion of seller financing. How much seller financing was provided under this program and what type of properties were financed?

A1(a). As of September 30, 1990, 255 properties with seller financing were sold out of receivership. They consisted of 200 single family residences and 55 commercial properties or parcels of land. A total of $22.1 million of seller financing was provided. Aggregate sales totaled $28.3 million for these 255 properties.

Q1(b). What, if any, problems did you encounter in the previous program that the Oversight Board hopes to rectify under the new program, i.e., how does this new program differ from the old one?

A1(b). The Strategic Plan originally required a down payment of 25% which was considered too high by potential investors. As a result, the Oversight Board, in Policy Statement 13, specifically addressed the issue of seller financing.

That Policy statement reduced the down payment requirements to 15%. In addition, to assure marketability of the loans made by RTC, Policy Statement 13 required that seller financing only be offered where the RTC determined that the loan could be sold on a non-recourse basis in the secondary market within one year.

A1(b). The requirement for a predetermination that loans be readily marketable within one year in secondary markets prevented many loans from being made. In response the Oversight Board, by resolution on October 24, 1990, removed this requirement but charged the RTC with attempting to move these loans into the secondary markets as expeditiously as possible.

To further enhance the RTC's ability to dispose of hard to sell assets, the Oversight Board further addressed seller financing in Policy Statement 15 on December 7, 1990. While still encouraging down payments of 15%, RTC was given greater flexibility in making loans on illiquid assets by allowing arrangements that may include other forms of equity commitments, such as funded escrows for capital improvements to the property. In addition, Policy Statement 15 reaffirmed RTC's affordable housing seller financing policy, providing a minimum of $250 million to finance sales of single family homes.

Q1(c). Since RTC seller financing is only available when other financing is not, what information does the Oversight Board have concerning the availability of credit? Is there a credit crunch generally or only for RTC assets?

A1(c). The Regional Advisory Boards, the National Advisory Board, and a number of real estate industry trade groups, all report that there is a lack of liquidity in the real estate markets generally. The "credit crunch" has affected all borrowers; it is not confined to buyers of RTC assets.

In addition, semiannually, RTC surveys lending institutions on a regional basis to determine the availability of financing and the need for RTC financing for specific types of locations of properties.

Q1(d). The $7 billion dollar program will be available to finance all RTC assets. What proportion of the funding do you anticipate will be used to finance real estate sales? What other assets do you anticipate will be sold under this program?

A1(d). At least $250 million of seller financing is being reserved to help finance affordable housing with the remainder being used to finance other real estate and illiquid assets.

Of the remaining $6.75 billion, $4.75 billion would be allocated among the regions on the basis of the book value of their respective real estate owned inventories. The final $2 billion would be reserved to finance bulk sales of illiquid assets.

Q1(e). Seller financing is being used to help speed sales of assets. What is the average holding period of RTC owned real estate? How much do you expect to reduce this holding period by the seller financing program?

A1(e). The average amount of time RTC real estate owned has been in receivership is 7 months.

It is expected that the seller financing will reduce the overall holding period by encouraging earlier sales and the sales of property which, lacking seller financing, would not be easily sold.

Q1(f). The primary purpose of providing seller financing is to help the RTC sell properties. Of course, if the RTC retains too great a risk, property sales may turn out to be more like purchase options. What kind of down payment and recourse against the purchaser will be required under the new seller financing program?

A1(f). RTC Seller Financing Guidelines discourage transactions involving a down payment of less than 25% unless there is some personal recourse to the borrower. Additionally, the Oversight Board has recommended a minimum down payment of 15% except where seller financing is offered

to eligible buyers of affordable housing. In those instances, down payments can be reduced to 5% or even less in certain instances where there are other types of equity commitments such as funded escrows.

Q2. There has been a lot of attention focused on soft real estate markets, particularly in the Northeast. There have been longstanding concerns that dumping RTC assets in fragile real estate markets will exacerbate the problem.

Q2(a). Is the RTC concerned about the effect of huge asset sales on soft real estate markets?

Q2(b). What analysis has the RTC performed to assess the impact of asset sales on these markets?

A2(a & b) The RTC is very concerned about any adverse impact that large asset sales may have on any market. As a result of that concern, the RTC has consulted with the six Regional Advisory Boards to assess the impact of large real estate sales.

The Advisory Boards have been unanimous in encouraging aggressive sales, and they do not presently express concerns about the RTC throwing real estate markets into turmoil by "dumping" into a soft market.

The RTC also consults regularly with real estate industry trade groups, which have emphasized the importance of the RTC's aggressive marketing in real estate. For some, such as the National Association of Realtors, this represents a reversal of their former position. Other industry representatives are more concerned about the detrimental effect of the RTC's "overhang" of real estate inventory.

Q3. It is pretty well accepted that the failure to promptly close insolvent institutions significantly increased the cost of the savings and loan crisis. Insolvent institutions keep bleeding losses, until they are buried once and for all.

Q3(a). The RTC has 184 insolvent institutions in conservatorships and hundreds more on the way from OTS. How badly are these institutions bleeding. In other words, how fast are these institutions generating losses?

A3(a). According to the RTC's Office of Research and Statistics, 206 institutions in conservatorship during the third quarter of 1990 incurred operating losses of $863 million.

The OTS reported that Group III institutions lost $230 million and that Group IV institutions lost $1.05 billion in the third quarter of calendar 1990.

The OTS also reported that 57% of the Group III institutions and 36% of Group IV institutions reported profits for the third quarter of 1990.

There were 356 institutions classified as Group III and 218 Institutions classified as Group IV for this period.

Q3(b). While the RTC claims to have "resolved" 332 thrifts with $99.5 billion in assets, only one-third ($32.5 billion) of the assets have been sold as part of the resolution. If the RTC transfers deposits but holds on to the assets, the bleeding doesn't stop. Aren't asset sales a better indication of resolutions than the number of thrifts placed in receivership? If so, how would you grade the progress of the RTC?

A3(b). Resolutions stop operating losses and may ease competitive pressures within the system caused by unhealthy thrifts paying above-market rates to retain deposits. Losses subsequently recognized by RTC on assets retained or put back to the RTC by acquirers existed at the time of resolution.

Asset sales are not a better indication of resolutions since the disposition of assets is not necessarily related to a particular institution. Placing an institution in receivership, however, puts that institution under direct supervisory control, permits the

A3(b). RTC to substitute lower cost funds, and prevents the further dissipation of resources into projects which are a source of losses.

Q4. The OTS reports that it has 218 thrifts with $152 billion in assets (with a 3rd quarter 1990 net loss o over $1 billion) in so-called group 4 that are earmarked for transfer to the RTC. In addition, there are another 356 thrifts with $191 billion in assets (with a 3rd quarter 1990 net loss of $230 million) in so-called group 3 that fail to meet capital requirements and are not likely to raise needed capital.

Q4(a). One of the more prominent deposit insurance reform proposals would require a failing institution to be closed before it becomes insolvent. The concept is that if an institution is closed and sold before insolvency the deposit insurance fund will not suffer any loss. Do the OTS and the FDIC have sufficient authority to close these thrifts down before they become insolvent and add to the cost of the bailout? If so, is it being done? If not, should Congress provide that authority now on an emergency basis to keep the cost of the savings and loan crisis from growing?

A4(a). OTS can, and does, assert its authority to close or order the cessation of activities of any thrift it believes is operating in an unsafe and unsound manner. Whether regulatory authorities should be given additional powers in this area should be considered in the context of the other changes affecting financial institutions.

Q4(b). What is the estimated loss to the RTC of thrifts in OTS groups 3 and 4?

A4(b). The upper end of the estimated cost of resolving all RTC institutions is $132 billion. Of this amount, approximately $20 - $25 billion is for resolving those institutions in Group III. An additional $30 - $35 billion is for resolving institutions in Group IV.

Q4(c). I understand that the OTS has an Accelerated Resolution Program (ARP) designed to sell thrifts before they are transferred to the RTC. How successful has this program been? How many thrifts have been sold and what is the estimated savings to the RTC?

A4(c). As of February 8, 1991, of the 10 institutions originally slated for the ARP pilot program, one was sold before the program started, 7 have been sold as ARP resolutions, another sale is believed to be imminent, and one institution failed prior to being resolved in this manner. Any estimates of savings as a result of the ARP are difficult to quantify and based on a number of assumptions about the likely deterioration of franchise value during conservatorship, including deposit runoff, and the premiums which might have been realized in an alternative form of resolution. It has been estimated that the recent pilot may have saved as much as $100 million on assets of approximately $8 billion. In the next stage, RTC plans to target between 20-30 institutions for resolution under the ARP.

Q5. When the RTC was formed, Congress realized that the government could use all the private sector help that was available to sell assets. The idea was to get some sharp real estate experts to manage the assets and to sit on the government's side of the table during negotiations for asset sales.

Q5(a). To what extent has the RTC relied on the private sector to manage and sell assets?

A5(a). The RTC is relying heavily on the private sector to manage and dispose of assets. So far, $11 billion of assets are under private management, and solicitations have been issued to contract for an additional $13 billion of assets.

Q5(b). What proportion of RTC assets are under management contracts?

A5(b). Sixty-seven percent of RTC assets either are under private management or are subject of a solicitation to be placed under private management.

Q5(c). How has the pace of sales of assets under private management compared with assets managed by RTC personnel?

A5(c). The program for placing assets under private management was slow in getting started because of the poor quality of the records inherited by the RTC from failed institutions concerning their asset holdings. Consequently, there is not yet sufficient data with which to compare the sales performance of private managers with that of RTC personnel.